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No. 08-1022

In The
Supreme Court of the United States

VENTAS FINANCE I LLC,

Petitioner,

v.

CALIFORNIA FRANCHISE TAX BOARD,

Respondent.

On Petition For A Writ Of Certiorari To The Court Of Appeal Of California, First Appellate District

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether California violated petitioner's rights under the Due Process Clause to a "clear and certain remedy" for the payment of an unconstitutional tax when, after holding the unapportioned tax unconstitutional and not subject to judicial reformation by adding an apportionment mechanism, the lower court denied petitioner the settled State law remedy of invalidating the tax, and instead ordered a refund of only the difference between the amount of tax originally paid and the amount petitioner would have paid under a constitutionally valid, *i.e.*, apportioned, tax scheme.

2. Whether California violated petitioner's rights under the Due Process Clause by retroactively adding an apportionment mechanism to a tax, and thereby changing the tax law, and petitioner's obligations under that law, for at least the prior eight years.

RULE 29.6 STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, petitioner states that it is a wholly owned subsidiary of Ventas, Inc.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
RULE 29.6 STATEMENT	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	v
PETITION FOR A WRIT OF CERTIORARI	1
OPINIONS BELOW	1
JURISDICTION	1
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	1
STATEMENT	2
1. Ventas' Business	5
2. California's Taxing Scheme	6
3. Claim For Refund	8
4. The Proceedings Below	8
REASONS FOR GRANTING THE WRIT	12
I. THE DECISION BELOW CONTRAVENES THE DUE PROCESS REQUIREMENT THAT A STATE PROVIDE A "CLEAR AND CERTAIN REMEDY" FOR THE COLLECTION OF UNCONSTITUTIONAL TAXES	12
A. The Remedy Prescribed By California Violates Due Process Because California Changed Its Remedial Scheme In Mid-course To Deny Petitioner The Full Refund It Was Owed	12

TABLE OF CONTENTS – Continued

Page

B. The Remedy Prescribed By California Also Violates Due Process Because The Period Of Retroactivity Is Excessive 18

II. REVIEW IS WARRANTED BECAUSE THE QUESTIONS PRESENTED ARE IMPORTANT AND RECURRING 21

CONCLUSION 23

APPENDIX

Opinion of the California Court of Appeal .....App. 1a

Judgment of the Superior Court of San Francisco .....App. 48a

Tentative Decision of the Superior Court of San Francisco .....App. 52a

Order of the California Supreme Court.....App. 58a

Assembly Bill No. 198 .....App. 59a

State Statutes .....App. 67a

TABLE OF AUTHORITIES

Page

CASES:

ANR Pipeline Co. v. La. Tax Comm'n,
923 So. 2d 81 (La. Ct. App. 2005) 21

Atchison, Topeka & Santa Fe Ry. v. O'Connor,
223 U.S. 280 (1912) 3

Ceridian Corp. v. Franchise Tax Bd.,
85 Cal. App. 4th 875, 102 Cal. Rptr. 2d 611
(Cal. Ct. App. 2000) 11, 15, 17

City of Modesto v. National Med., Inc.,
128 Cal. App. 4th 518, 27 Cal. Rptr. 3d 215
(Cal. Ct. App. 2005) 9

Complete Auto Transit, Inc. v. Brady,
420 U.S. 274 (1977) 8

Container Corp. of Am. v. Franchise Tax Bd.,
463 U.S. 159 (1983) 20

Eddie Bauer, Inc. v. Director of Revenue,
70 S.W.3d 434 (Mo. 2002) 21

Harper v. Virginia Dept. of Taxation,
462 S.E.2d 892 (Va. 1995) 21

Harper v. Virginia Dept. of Taxation,
509 U.S. 86 (1993) 21

Kopp v. Fair Pol. Practices Com.,
11 Cal.4th 607, 47 Cal. Rptr. 2d 108
(Cal. 1995) 11, 15

Landgraf v. USI Film Products,
511 U.S. 244 (1994) 20

TABLE OF AUTHORITIES – Continued

Page

Macy's Department Store, Inc. v. City and County of San Francisco, 143 Cal. App. 4th 1444, 50 Cal. Rptr. 3d 79 (Cal. Ct. App. 2006).....21

McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 496 U.S. 18 (1990).....3, 13, 16, 19, 21

Newsweek, Inc. v. Florida Dep't of Revenue, 522 U.S. 442 (1998).....13, 14, 21

Northwest Energetic Services, LLC v. Franchise Tax Bd., 159 Cal. App. 4th 841, 71 Cal. Rptr. 3d 642 (Cal. Ct. App. 2008).....7

Polar Tankers, Inc. v. City of Valdez, Docket No. 08-310.....21

Reich v. Collins, 513 U.S. 106 (1994).....4, 13, 14, 17, 21

United States v. Carlton, 512 U.S. 26 (1994).....4, 18

United States v. Darusmont, 449 U.S. 292 (1981).....18

W.R. Grace & Co. v. Dept. of Revenue, 973 P.2d 1011 (Wash. 1999).....21

Welch v. Henry, 305 U.S. 134 (1938).....18

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTION:

Commerce Clause
U.S. Const. art. I, § 8, cl. 3 ..... *passim*

Due Process Clause
U.S. Const. amend. XIV, § 1 ..... *passim*

STATUTES:

Cal. Rev. & Tax. Code
§ 17941(a) 6
§ 17941(b) 6
§ 17941(b)(1) 8
§ 17942 ..... *passim*
§ 17942(a) 6
§ 19382 14
§ 19385 14
§ 19394 10
§ 24271 6
§§ 25120-25139 ..... 2, 19
§ 25135 10
§ 25136 10
§ 25137 10
§ 25139 ..... 2, 19

28 U.S.C. § 1257(a) 1

PETITION FOR A WRIT OF CERTIORARI

Petitioner Ventas Finance I LLC respectfully petitions for a writ of certiorari to review the judgment of the Court of Appeal of California, First Appellate District.

OPINIONS BELOW

The opinion of the Court of Appeal (App., *infra*, 1a-47a), is reported at 165 Cal. App. 4th 1207, 81 Cal. Rptr. 3d 823 (Cal. Ct. App. 2008). The decision of the Superior Court of San Francisco County (App., *infra*, 52a-57a) is unreported.

JURISDICTION

The judgment of the Court of Appeal of California was entered on August 11, 2008. The Supreme Court of California denied petitioner's petition for review on November 12, 2008. (App. 58a.) The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Fourteenth Amendment to the United States Constitution, U.S. Const. amend. XIV, § 1, provides: "No State shall . . .

deprive any person of life, liberty, or property, without due process of law."

The Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The following sections of the California Revenue & Taxation Code: former Section 17942, Sections 25120 through 25139. These provisions are reproduced at App. 67a-82a.

STATEMENT

For the period at issue in this case, California law required a limited liability company ("LLC") to pay annually a tax (the "LLC Tax") measured by its entire, worldwide gross receipts. That is, the LLC Tax was not calibrated to only receipts attributable to California activity – it was unapportioned. Both the trial court and the California Court of Appeal in this case determined that the LLC Tax violated the fair apportionment requirement of the Commerce Clause and that this defect could not be cured by reforming the statute, e.g., by adding an apportionment mechanism.

Having determined that the LLC Tax could not be saved through reformation, the trial court held that petitioner was entitled to a refund of all LLC

Taxes paid. Despite its agreement that the LLC Tax could not be reformed, the Court of Appeal reversed the trial court's order of a full refund. Specifically, the court below concluded that the Due Process Clause did not require a full refund and that it knew "of no other principle of state law or state or federal due process that would entitle [petitioner] to a [full refund]." (App. 41a.) On that basis, the Court of Appeal concluded that the State should refund only the difference between the amount petitioner paid and the amount it would have paid under a constitutional statute, i.e., one using a method of fair apportionment. (App. 42a.)

The Court of Appeal's decision violates two fundamental principles of the Due Process Clause. First, under this Court's precedents, when a State requires a taxpayer "promptly to pay a tax when due" and then dispute the legality of that tax, as California did in this case, Due Process requires the State to provide "meaningful backward-looking relief" and a "clear and certain remedy for any erroneous and unlawful tax collection to ensure that the opportunity to contest the tax is a meaningful one." *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco,* 496 U.S. 18, 39 (1990), quoting *Atchison, Topeka & Santa Fe Ry. v. O'Connor,* 223 U.S. 280, 285 (1912). Furthermore, once the State establishes a particular remedy for the payment of an unconstitutional tax, the State is required to make good on the promise of that remedy. That is, the State is prohibited from "reconfigur[ing] its [remedial] scheme, unfairly, in

mid-course – to 'bait and switch'" the established remedy. *Reich v. Collins*, 513 U.S. 106, 111 (1994).

California law has long held that an unconstitutional statute may be saved from invalidation only if it can be reformed. The Court of Appeal properly applied the rigorous requirements for determining whether a statute can be reformed, designed to prevent courts from engaging in judicial legislation, and concluded that those requirements were not satisfied for the LLC Tax. Thus, if the Court had made good on California's promised remedial scheme, it would have recognized that the LLC Tax was invalid and upheld the Superior Court's order of a full refund.

However, the Court of Appeal denied petitioner this settled remedy. Instead, as noted, the lower court ordered a refund based only on "the difference between the levy actually paid and the amount that could be collected without violating the Commerce Clause using a proper method of apportionment." (App. 42a.) The Court of Appeal's decision allows the State to avoid paying the full refund required by the settled State law remedy and constitutes a classic "bait and switch," i.e., reconfiguration of the State's remedial scheme in mid-course, in violation of the Due Process Clause.

Second, the Due Process Clause prohibits changes in tax obligations that extend on a retroactive basis for more than a "modest period." *United*

States v. Carlton, 512 U.S. 26, 32-33 (1994) (upholding retroactive tax legislation extending back "slightly greater than one year"). The Court of Appeal's decision requires the Superior Court, on remand, to redesign the LLC Tax to include an apportionment scheme that comports with Commerce Clause requirements. Because petitioner's refund claim covers the years 2001 through 2003, this new scheme will apply retroactively for up to eight years.

The law places a heavy burden on petitioner to show the new apportionment formula properly reflects the taxpayer's in-state activities and, thus, satisfies constitutional standards. To require petitioner to produce the evidence necessary to meet that burden, at this late date, places an unreasonable and unfair burden on petitioner, plainly is not modest, and therefore violates the Due Process bar on retroactive changes in tax law.

The remedies for unconstitutional taxes are vitally important. A determination that a tax is unconstitutional is rendered meaningless if the State court's remedy is unconstitutional. To resolve these recurring issues, and to provide State courts much-needed guidance, this petition should be granted.

1. Ventas' Business

Between 2001 and 2003, petitioner was an LLC organized under the laws of the State of Delaware and a wholly-owned, second-tier subsidiary of Ventas,

Inc., a health care real estate investment trust. Petitioner held title to certain rental properties (all skilled nursing facilities).

During 2001 and 2002, petitioner owned forty properties, three of which were in California. In 2003, petitioner sold one of the non-California properties, reducing its holdings to thirty nine facilities. Other than its ownership of the three properties, petitioner had no physical presence in California – no other property, no employees, and no representatives acting on its behalf. Petitioner was not required to perform any services under the leases and, in fact, did not perform any services for the properties or the lessee.

2. California's Taxing Scheme

By statute, an LLC is liable for tax imposed by Cal. Rev. & Tax. Code § 17942, the LLC Tax (or "Section 17942"), if either (a) it is "doing business" in California, or (b) even if the LLC conducts no business in California, the Secretary of State has accepted the LLC's articles of organization or has issued the LLC a certificate of registration. Cal. Rev. & Tax. Code §§ 17941(a), 17941(b), and 17942(a). Pursuant to former Section 17942(a), an LLC's liability for the LLC Tax was computed on the basis of its "total income from all sources reportable in this state for the taxable year."[1]

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[1] The statute further defines "total income" as "gross income as defined in Section 24271 [of the Cal. Rev. & Tax. Code], plus the cost of goods sold that are paid or incurred in

(Continued on following page)

For the years at issue, it was undisputed that "total income from all sources reportable in this state for the taxable year" means the LLC's "total income," wherever earned, and without apportionment. (Apportionment would calibrate the LLC Tax to the LLC's in-state activity and would thereby remove from the taxable base income earned outside California's borders.) Indeed, when the LLC Tax was first enacted, the Legislature expressly considered, but then rejected, inclusion of an apportionment mechanism, in particular the mechanism used in California for corporate income tax purposes. Due to the absence of any apportionment mechanism, petitioner paid to California the same LLC Tax as any other LLC earning the same amount of total annual income as petitioner, even if the other LLC conducted a much greater proportion of its activity in California (e.g., 100%).

Prompted by this case and a related case,[2] tens of thousands of LLCs have filed claims for refund of

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connection with the trade or business of the taxpayer." Cal. Rev. & Tax. Code § 17942. This amount is also commonly referred to as a taxpayer's "gross receipts."

[2] *Northwest Energetic Services, LLC v. Franchise Tax Bd.*, 159 Cal. App. 4th 841, 71 Cal. Rptr. 3d 642 (Cal. Ct. App. 2008), held that the LLC Tax violated the Commerce Clause due to the lack of apportionment, and that the taxpayer in that case was entitled to a full refund of all amounts paid under Section 17942. However, the California court did not reach the core issue in this case, i.e., the proper remedy of a taxpayer with business activity both within and without the State, because Northwest Energetic Services, LLC had no business activity or presence in California,

(Continued on following page)

amounts paid under Section 17942. According to respondent, the potential refunds at issue for LLCs with activities both within and without the State are at least $215 million. (App. 7a.)

3. Claim For Refund

Petitioner paid the following amounts pursuant to respondent's interpretation of Section 17942: $6,000, $11,790, and $11,790 for 2001, 2002, and 2003, respectively. On January 4, 2005, petitioner filed a timely claim for refund of all of the amounts paid pursuant to Section 17942. Respondent denied that claim, and petitioner timely filed this lawsuit.

4. The Proceedings Below

(a) **The Superior Court.** The Superior Court issued its decision in this case in November 2006. In light of the "fundamental constitutional principle governing state taxation . . . that a state must be fairly apportioned" – that is, it must be adjusted to the level of activity in the state (App. 53a-54a, citing *Complete Auto Transit, Inc. v. Brady,* 420 U.S. 274, 279 (1977)), the Superior Court held that the unapportioned LLC Tax violated the Commerce and Due Process Clauses. (App. 54a.)

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and had become subject to the LLC Tax pursuant to Section 17941(b)(1) merely by registering to engage in business in the State.

Addressing the remedy for the constitutional violation, the Superior Court held that the LLC Tax could not be saved from invalidity through judicial reformation. Judicial reformation, the court explained, is a "narrow exception to the principle that an unconstitutional statute is *unenforceable*, and is appropriate only when a court 'can say with confidence that (i) it is possible to reform the statute in a manner that closely effectuates policy judgments clearly articulated by the enacting body, and (ii) the enacting body would have preferred the reformed construction to invalidation of the statute.'" (App. 54a (emphasis added), quoting *City of Modesto v. National Med., Inc.*, 128 Cal. App. 4th 518, 27 Cal. Rptr. 3d 215 (Cal. Ct. App. 2005).) Applying these standards, the Superior Court concluded that the legislative history establishes that the Legislature "considered and rejected apportionment of the [LLC Tax]" and respondent "had provided no evidence of the type of apportionment mechanism the Legislature would have enacted." (App. 54a.)

Having held that the LLC Tax could not be judicially reformed, the Superior Court concluded that former Section 17942 was invalid and petitioner was "entitled to a refund of all amounts paid, plus interest and costs as provided by law." (App. 55a.)

(b) **Post-Judgment Legislation**. In October 2007, California enacted Assembly Bill 198 ("AB 198"), which amended Section 17942 for taxable years beginning on and after January 1, 2007 to provide for apportionment of the LLC Tax according to "the rules

for assigning sales under [Cal. Rev. & Tax. Code] Sections 25135 and 25136 and the regulations thereunder, as modified by regulations under Section 25137 . . . " (App. 63a.)

In addition, to address the treatment of claims for refund of the LLC Tax in the event the LLC Tax was "finally adjudged" unconstitutional, AB 198 added new Section 19394 to the Revenue & Taxation Code, which provides that the LLC Tax "shall be recomputed by the Franchise Tax Board for the taxable year in question . . . only to the extent necessary to remedy the [constitutional violation]." (App. 64a-65a.) New Section 19394 expressly applies to "suits for refund filed on or after the date of enactment of this act and suits for refund filed before that date that are not final as of that date." (App. 65a.)

(c) **The Court of Appeal.** In August 2008, the Court of Appeal affirmed, in part, and reversed, in part, the decision of the Superior Court. Specifically, the Court of Appeal affirmed the Superior Court's holding that the LLC Tax "violates the Commerce Clause to the extent it fails to provide a method of fair apportionment." (App. 20a.)

Likewise, the Court of Appeal affirmed the Superior Court's holding that the LLC Tax could not be judicially reformed through the addition of an apportionment mechanism as advocated by respondent. Like the Superior Court, the Court of Appeal recognized that reformation is a narrow remedy:

> "'[A] court may reform – i.e., "rewrite" – a statute in order to preserve it against invalidation under the Constitution, when we can say with confidence that (i) it is possible to reform the statute in a manner that closely effectuates policy judgments clearly articulated by the enacting body, and (ii) the enacting body would have preferred the reformed construction to invalidation of the statute."

(App. 24a, quoting *Ceridian Corp. v. Franchise Tax Bd.*, 85 Cal. App. 4th 875, 889, 102 Cal. Rptr. 2d 611 (Cal. Ct. App. 2000)). These requirements ensure that "courts . . . steer clear of 'judicial policy making; in the guise of reformation, and thereby avoid encroaching on the legislative function in violation of the separation of powers doctrine.'" (App. 24a, quoting *Kopp v. Fair Pol. Practices Com.*, 11 Cal.4th 607, 661, 47 Cal. Rptr. 2d 108 (Cal. 1995).) The court concluded that the requirements for judicial reformation were not satisfied in this case "because the legislative history reflects that the Legislature actually considered, and rejected, a version including precisely the language the FTB now suggests." (App. 27a.)

Nevertheless, the Court of Appeal reversed the Superior Court's order of a full refund of all LLC Taxes paid by petitioner, concluding that the State need only provide petitioner "a refund of the difference between the levy actually paid and the amount that could be collected without violating the Commerce Clause using a proper method of apportionment." (App. 42a.) The Court of Appeal stated: "We

know of no other principle of state or federal due process that would entitle it to a remedy that does more than that." (App. 41a.) The Court of Appeal dismissed petitioner's Due Process contentions, stating that a partial refund "would [not] undermine the clarity or certainty of the remedy in a manner inconsistent with due process [because t]he parties have already stipulated to [petitioner's] California apportionment percentage for each of the years in issue using California's apportionment methodology for corporations." (App. 41a.)

(d) **The California Supreme Court.** On November 12, 2008, the California Supreme Court denied Ventas' petition for review. (App. 58a.)

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW CONTRAVENES THE DUE PROCESS REQUIREMENT THAT A STATE PROVIDE A "CLEAR AND CERTAIN REMEDY" FOR THE COLLECTION OF UNCONSTITUTIONAL TAXES.

A. The Remedy Prescribed By California Violates Due Process Because California Changed Its Remedial Scheme In Mid-course To Deny Petitioner The Full Refund It Was Owed.

This Court has consistently held that when a taxpayer has paid State taxes declared to be unconstitutional or unlawfully collected, the Due Process

Clause of the Fourteenth Amendment requires that State to provide "meaningful backward-looking relief in the form of a 'clear and certain remedy' . . . to ensure that the opportunity to contest the tax is a meaningful one." *McKesson Corp.*, 496 U.S. at 31, 39 (citations omitted); *see also Newsweek, Inc. v. Florida Dep't of Revenue,* 522 U.S. 442, 445 (1998) (per curiam). Consistent with these Due Process mandates, a State may require a taxpayer to pay a disputed tax before challenging its validity, as California did here. Moreover, where such a challenge results in a determination that the tax is unconstitutional, the specific remedy for the substantive constitutional violation is left to State law. *McKesson*, 496 U.S. at 51-52. However, once the State has established its remedial scheme, federal Due Process entitles a taxpayer to the remedy dictated by that scheme. That is, the State may not "reconfigure its scheme, unfairly, in mid-course – to 'bait and switch'" the established remedy. *Reich,* 513 U.S. at 111 (citations omitted).

Applying these principles, this Court in *Reich* held that Georgia's attempt to deny taxpayers the right to a refund based on the existence of a predeprivation remedy, when it held out the right to a postdeprivation remedy on which taxpayers could reasonably rely, was unconstitutional. This Court recognized that "Georgia has the flexibility to maintain an exclusively predeprivation scheme, so long as the scheme is 'clear and certain.'" *Reich*, 513 U.S. at 110-11. "But what a State may *not* do," this Court continued:

> and what Georgia did here, is to reconfigure its scheme, unfairly, in *mid-course* – to "bait and switch," as some have described it. Specifically, in the mid-1980's, Georgia held out what plainly appeared to be a "clear and certain" postdeprivation remedy, in the form of its tax refund statute, and then declared, only after Reich and others had paid the disputed taxes, that no such remedy exists.

Id. at 111 (emphasis in original). In short, if the State holds out a particular postdeprivation remedy for an unconstitutional tax, it must make good on that commitment. *See id.* at 108; *see also Newsweek, supra* (summarily vacating Florida decision in which State court had denied relief using "bait and switch" tactics condemned in *Reich*).

The remedy ordered by the court below is a classic "bait and switch." California law provides for a postpayment refund of taxes determined to be void. Cal. Rev. & Tax. Code § 19382 ("Except as provided in Section 19385, after payment of the tax and denial by the Franchise Tax Board of a claim for refund, any taxpayer claiming that the tax computed and assessed is void in whole or in part may bring an action, upon the grounds set forth in that claim for refund, against the Franchise Tax Board for the recovery of the whole or any part of the amount paid."). California law further provides that when a State tax statute is unconstitutional, "in order to preserve it against invalidation" under the Constitution, "'a court may reform – i.e., "rewrite" – a statute . . . when

we can say with confidence that (i) it is possible to reform the statute in a manner that closely effectuates policy judgments clearly articulated by the enacting body, and (ii) the enacting body would have preferred the reformed construction to invalidation of the statute.'" *Ceridian*, 85 Cal. App. 4th at 889, quoting *Kopp*, 11 Cal.4th at 660-661. Stated differently, the remedy held out by California for an unconstitutional State tax is either reformation or, if the requirements for judicial reformation are not satisfied, invalidation. This is the "procedural safeguard" promised to California taxpayers by California law to ensure that "courts . . . steer clear of 'judicial policymaking' in the guise of statutory reformation, and thereby avoid encroaching on the legislative function in violation of the separation of powers doctrine." (App. 24a, quoting *Kopp*, 11 Cal.4th at 661.)

Here, the court below affirmed the trial court's holding that the LLC Tax violated the Commerce Clause due to lack of apportionment. (App. 20a; App. 53a-54a.) After holding the LLC Tax unconstitutional, both the trial court and the court below applied the settled law regarding remedies, and readily determined that judicial reformation (i.e., adding an apportionment mechanism) was prohibited. (App. 27a-28a; App. 54a-55a.) The trial court determined, "[n]either the statute nor the legislative history contained any indication of the type of apportionment mechanism the Legislature would have enacted." (App. 54a-55a.) Likewise, the California Court of Appeal concurred: "We cannot say with confidence

that the proposed reformation would be consistent with the legislative policy judgment underlying former section 17942, because the legislative history reflects that the Legislature actually considered, and rejected, a version including precisely the language the FTB now suggests." (App. 27a.)

Because the court below concluded it could not judicially reform the LLC Tax to add an apportionment mechanism, the remedy required under California law is invalidation of the tax statute. With the tax invalidated, and thus no legal basis remaining for the State to retain taxes paid under that statute, California law requires the State to refund all taxes collected under the void tax statute. *See McKesson,* 496 U.S. at 39 (where a tax is invalid, the State has "no choice" but to refund the entire amount of taxes paid).

Despite its determination that the LLC Tax could not be reformed and, thus, was void, the Court of Appeal held that the State could nonetheless retain a portion of the taxes collected under the void statute. Without citing any authority, the court concluded that the State need only provide "a refund of the difference between the levy actually paid and the amount that could be collected without violating the Commerce Clause using a proper method of apportionment." (App. 42a.) The court's only defense for this holding was that "[w]e know of no other principle of state or federal due process that would entitle it to a remedy that does more than that." (App. 41a.)

Of course, the principle of Due Process law that requires a full refund in this case is the "bait and switch" doctrine announced by this Court in *Reich*. As set forth above, California held out the remedy of invalidation of an unconstitutional tax that does not satisfy the requirements for judicial reformation. *See Ceridian*, 85 Cal. App. 4th at 889. The Court of Appeal denied petitioner this settled remedy, substituting in "mid-course" a different remedy which the court articulated as follows: regardless of whether the unconstitutional tax can be judicially reformed, the State need only provide "a refund of the difference between the levy actually paid and the amount that could be collected without violating the Commerce Clause using a proper method of apportionment." (App. 42a.)

In sum, if California had intended to subject taxpayers to the remedy announced in the decision below, California was required to inform taxpayers of both the remedial law and the consequences of pursuing the State's postpayment procedures to challenge State taxes. To hold out a particular postdeprivation remedy in the form of reformation or invalidation of an unconstitutional tax and then declare, only after the taxpayer has paid the disputed taxes and pursued that remedy, that an entirely different remedy based on a yet-to-be-determined, hypothetical tax scheme governs this action, violates this Court's well-settled Due Process precedents requiring a "clear and certain remedy." *Reich,* 513 U.S. at 111.

B. The Remedy Prescribed By California Also Violates Due Process Because The Period Of Retroactivity Is Excessive.

The remedy announced in the decision below also violates petitioner's rights under the Due Process Clause because it changes petitioner's tax obligations retroactively for up to eight years. The Due Process Clause permits retroactive changes in tax obligations if, among other things, they extend retroactively for only a "modest period" of no more than two years. *Carlton*, 512 U.S. at 32-33 (upholding retroactive tax legislation extending back "slightly greater than one year"); *United States v. Darusmont*, 449 U.S. 292, 296 (1981) (noting that Congress "almost without exception" has given general revenue statutes effective dates prior to the dates of actual enactment); *Welch v. Henry*, 305 U.S. 134 (1938) (upholding a Wisconsin income tax adopted in 1935 on dividends received in 1933).

Whereas the LLC Tax was previously unapportioned, in ordering as a remedy "a refund of the difference between the levy actually paid and the amount that could be collected without violating the Commerce Clause using a proper method of apportionment," (App. 42a), the court below has subjected petitioner to a new, yet-to-be-determined, apportionment scheme. Because petitioner's refund claim covers the years 2001 through 2003, the lower court's 2008 decision applies retroactively for up to eight years. Moreover, the lower court's remedy is no small change to the law governing petitioner's tax liability.

There are many different methodologies for achieving apportionment, and any given one of those possible methodologies is likely to require numerous statutes, regulations, and other interpretive authorities to describe and implement. *See, e.g.,* Cal. Rev. & Tax. Code §§ 25120-25139.

One of the key reasons for this limitation on retroactive tax changes is the Due Process promise that "the opportunity to contest [a] tax [be] a meaningful one." *McKesson Corp.,* 496 U.S. at 31, 39. In this case, the question on remand is what amount could the State have "collected without violating the Commerce Clause using a proper method of apportionment." There is no legal basis for concluding that the apportionment mechanism for corporate income tax purposes results in a proper method of apportionment of the different tax imposed by Cal. Rev. & Tax. Code § 17942, under the petitioner's specific facts. In fact, when the California Legislature enacted the LLC Tax, it specifically considered and rejected adoption of the apportionment mechanism for corporate income tax purposes. (App. 27a.) Moreover, when the Legislature prospectively amended the LLC Tax to provide for apportionment, it adopted a different apportionment methodology than the one applicable to the corporate income tax. (App. 63a.) Thus, notwithstanding the parties' stipulation of petitioner's California apportionment percentage under the State's corporate income tax law, the Court of Appeal's decision requires the parties to litigate the apportionment

methodology that satisfies the Commerce Clause for purposes of this tax and this taxpayer.

Moreover, it is petitioner's "burden [to establish] by 'clear and cogent evidence'" the apportionment formula that satisfies constitutional requirements, i.e., that results in constitutional taxation. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983) (taxpayer has the "distinct burden of showing by 'clear and cogent evidence'" that the State's apportionment formula results in unconstitutional taxation). To satisfy this burden, petitioner would have to produce evidence, from approximately eight years ago, of its in-state and out-of-state business operations, including but not limited to, the source of its gross receipts and income, whether all of its income and receipts were derived from a unitary business, and the presence of any unusual transactions that may skew the standard corporate apportionment formula. At this late date, it is uncertain whether necessary documentary evidence and witnesses are available. There was no reason for petitioner to maintain such information because the original tax at issue lacked apportionment. The Court of Appeal's holding places an unreasonable and unfair burden on petitioner and violates the Due Process bar on retroactive changes in tax law extending for more than a modest period. *See also Landgraf v. USI Film Products*, 511 U.S. 244, 265 (1994) ("Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted.").

II. REVIEW IS WARRANTED BECAUSE THE QUESTIONS PRESENTED ARE IMPORTANT AND RECURRING.

The legal questions presented here are important and recurring. As the number of similar cases decided by this Court reveals, the question of whether a State tax violates the Constitution, and the related question of the appropriate remedy, routinely arise. *See, e.g.*, *Polar Tankers, Inc. v. City of Valdez*, Docket No. 08-310; *McKesson, supra*; *Reich, supra*; *Newsweek, supra*; *Harper v. Virginia Dept. of Taxation*, 509 U.S. 86 (1993). State court decisions also confirm that the remedy for an unconstitutional State tax remains a contentious issue. *See, e.g.*, *Macy's Department Store, Inc. v. City and County of San Francisco*, 143 Cal. App. 4th 1444, 50 Cal. Rptr. 3d 79 (Cal. Ct. App. 2006); *ANR Pipeline Co. v. La. Tax Comm'n*, 923 So. 2d 81 (La. Ct. App. 2005); *W.R. Grace & Co. v. Dept. of Revenue*, 973 P.2d 1011 (Wash. 1999); *Harper v. Virginia Dept. of Taxation*, 462 S.E.2d 892 (Va. 1995); *Eddie Bauer, Inc. v. Director of Revenue*, 70 S.W.3d 434 (Mo. 2002).

In prior cases decided by this Court, States had simply declined to refund the illegally collected taxes, and this Court made absolutely clear that denying a refund altogether violates Due Process. *See McKesson*, 446 U.S. at 31-32; *Reich*, 513 U.S. at 109-10. This case demonstrates that lower courts have not understood, or are disregarding, those precedents. The remedy established by the Court of Appeal in this case is a different way to achieve the same end of

reducing or eliminating the refund required after collection of unconstitutional taxes. Allowing States to enact unconstitutional taxes and then craft entirely new, retroactive tax schemes to remedy the constitutional violation would render illusory the Due Process Clause guarantee of a "clear and certain remedy" for an unconstitutional tax.

In fact, the lower court's holding is especially pernicious in that it encourages States to enact unconstitutional taxes with sweeping impact, knowing that if the taxes are struck down, the States will be entitled to retain the amount of taxes that could have been imposed under a constitutional version of the tax. For States, the longer the constitutional violations remain unredressed, the better. Without a "clear and certain remedy," taxpayers will be unlikely to invest the resources necessary to challenge unconstitutional taxes, and the constitutional violations may never be redressed. Particularly because unconstitutional taxes in general, and specifically the unapportioned tax at issue here, disproportionately burden out-of-state taxpayers who may not have the same safeguards afforded to in-state taxpayers, this Court should grant review of the decision below.



CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION ONE

VENTAS FINANCE I, LLC, Plaintiff and Respondent, v. CALIFORNIA FRANCHISE TAX BOARD, Defendant and Appellant.	A116277 and A117751 (San Francisco County Super. Ct. No. 05-440001) (Filed Aug. 11, 2008)

The California Franchise Tax Board (FTB) appeals from a judgment ordering a refund to Ventas Finance I (Ventas), a limited liability company (LLC), of $29,540, the entire amount it paid pursuant to former[1] Revenue and Taxation Code[2] section 17942 for the years 2001, 2002, and 2003, and a postjudgment order awarding attorney fees to Ventas in the amount

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[1] We refer to the version of Revenue and Taxation section 17942 at issue in this appeal as former section 17942, because in 2007, after the judgment was entered, and after the court entered a postjudgment order awarding attorney fees, the Legislature amended Revenue and Taxation Code section 17942 (Stats. 2007, ch. 381, § 2; see *post* at pp. 6-7.)

[2] All subsequent statutory references are to the Revenue and Taxation Code unless otherwise indicated.

of $ 215,016 pursuant to Code of Civil Procedure section 1021.5.

The trial court ordered the refund based upon its conclusion that, as applied to Ventas, the levy imposed by former section 17942 violated the Commerce Clause of the United States Constitution (U.S. Const., art. 1, § 8, cl. 3) (Commerce Clause) because the levy was based upon total income without apportionment to income attributable to, or derived from, California sources. Although at least some of Ventas's income did derive from California sources, the court ordered FTB to refund the entire amount.

In its postjudgment order awarding attorney fees, the court rejected FTB's contention that section 19717 is the exclusive means of obtaining fees in a tax refund suit. It further ruled that Ventas was the successful party within the meaning of Code of Civil Procedure section 1021.5, and that Ventas met the remaining criteria for an award of fees. In calculating the amount of reasonable fees, the court applied a 1.5 multiplier to a lodestar figure of $143,343.75.

We shall uphold the trial court's determination that former section 17942, as applied to Ventas, violates the Commerce Clause because it is not fairly apportioned, and that the court properly denied FTB's request that it judicially reform former section 17942 by rewriting it to include an apportionment mechanism. We shall also conclude, however, that neither federal due process nor any principle of California law requires FTB to refund the entire amount Ventas

paid. The refund should be limited to the amount Ventas paid for the years in issue that exceeds the amount it would have been assessed, without violating the Commerce Clause, using a method of fair apportionment.[3] We therefore shall reverse the judgment in part, and remand with directions to redetermine the amount of the refund. In all other respects, we shall affirm the judgment.

We shall also hold that section 19717 is not the exclusive means of obtaining attorney fees in a tax refund suit, and that fees may be awarded pursuant to Code of Civil Procedure section 1021.5, if the criteria specified therein are otherwise established. In light of the partial reversal of the underlying judgment, however, we cannot say with certainty that the court would exercise its discretion in the same manner. We therefore shall also reverse the post-judgment order awarding attorney fees, and remand with directions that the court may redetermine

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[3] In light of this disposition we shall not reach the question whether the newly enacted section 19394, which specifies a method for calculating the amount of refunds in the event that former section 17942 is finally adjudged to violate the Commerce Clause, may be applied to this case or whether any principle of due process would preclude its retroactive application.

We deferred ruling on FTB's request that we take judicial notice of a September 2007 legislative committee analysis and reanalysis of Assembly Bill No. 198, which added section 19394, and Ventas's request that we judicially notice the complete bill history. We do not reach any of the issues relating to the application of section 19394 and therefore deny these requests for judicial notice.

eligibility and the amount of reasonable fees in light of our partial reversal of the judgment.

FACTS[4]

1. The Suit for Refund.

Ventas was formed in 2001 as a limited liability company under the laws of the State of Delaware. It is wholly owned by Ventas, Inc., a Delaware real estate investment trust, and was formed to obtain financing secured by certain skilled nursing facilities to which Ventas held title. In 2001-2003, Ventas owned 39 to 40 facilities, three of which were located in California. Ventas had no other property, employees, or representatives working on its behalf in California.

On November 19, 2001, Ventas registered as a foreign LLC with the California Secretary of State, and remained registered through 2003. In 2001, 2002, and 2003 Ventas paid the $800 minimum tax imposed under section 17941. It also paid the following amounts imposed under former section 17942 based upon its "total income from all sources reportable to this state for the taxable year" (former § 17942, sub. (a)): 2001 – $6,000; 2002 – $11,790; 2003 – $11,790. In accordance with FTB's interpretation of former section 17942, Ventas reported its total income from all

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[4] This statement of facts is based primarily upon a "Joint Stipulation of Facts" and "Joint Stipulation Regarding Documents."

geographic sources to calculate the amount owed without apportionment to California sources. It was stipulated that if the apportionment methodology California uses for corporations (see § 25128 et seq.) were applied, Ventas's California apportionment percentage would have been only 8.06 percent, 8.34 percent and 6.94 percent, respectively, for these years.

On January 4, 2005, Ventas filed a timely claim for refund on the ground that former section 17942 contained no method for apportioning the levy to the proportionate amount of income earned, or attributable to economic activity, in California and therefore violates the Commerce Clause and the Due Process Clause of the United States Constitution. On February 24, 2005, and again on March 1, 2005, FTB informed Ventas that it had denied the refund claim. Although Ventas did not file an appeal to the State Board of Equalization, it did exhaust its administrative remedies for the purpose of filing a suit for refund, and timely filed its complaint seeking a refund.

After a trial based upon stipulated facts, the court held that former section 17942 is a tax and, as applied to Ventas, violates the Commerce Clause and due process, because it is based upon all income unapportioned to activities within California. The court refused FTB's request to reform former section 17942 to add an apportionment mechanism because the legislative history showed that the Legislature

had considered and rejected including an apportionment mechanism, and neither the statute nor the legislative history contained any indication of the type of apportionment mechanism the Legislature would have enacted. The court ordered that Ventas was entitled to a refund of the entire amount it paid pursuant to former section 17942, plus interest and costs for the years in issue. FTB filed a timely notice of appeal from the judgment.

2. The Motion for Attorney Fees.

Ventas thereafter filed a motion seeking attorney fees pursuant to Code of Civil Procedure sections 1021.5 and 1032, subdivision (b). The case was accepted on a contingency fee basis. Based upon standard billing rates, the attorney fees actually incurred through November 2006 would have totaled $143,343.75. Ventas sought $30 million in fees.

This request for a substantial upward adjustment of the lodestar figure was largely predicated upon the theory that this case was the second of two filed by the same attorneys for different plaintiffs that, if upheld, would entitle tens of thousands of LLC's registered in California to obtain refunds estimated to total as much at $1.4 billion, and no less than $300 million.

In the first case, *Northwest Energetic Services LLC v. Franchise Tax Board* (Super Ct. S.F. City and County, 2005, No. CGC 05-437721), the same attorneys who represented Ventas had already obtained a

judgment ruling that former section 17942 was unconstitutional as applied, and an award of $3.5 million in attorney fees.[5] The plaintiff LLC in that case, however, did not earn any income that could be sourced to California, and there had been no dispute that it was entitled to a refund of all amounts it had paid. Ventas argued the instant litigation was necessary to address FTB's position that only those LLC's that had no income attributable to California sources were entitled to a full refund. In all other cases, FTB maintained that the appropriate remedy was to refund the difference between the amount the LLC paid and the amount it would have paid if former section 17942 included a fair apportionment mechanism. Ventas reasoned that this litigation conclusively resolved issues left unresolved after the *Northwest* trial by establishing that former section 17942 could not be judicially reformed, and that any LLC who paid the levy is entitled to a full refund.

FTB, on the other had, estimated the amount of potential refunds as a result of the *Northwest* trial and this case was closer to $215 million. FTB based its much smaller estimate on its determination that approximately 93 percent of LLC's earned all of their income from California sources. It reasoned that, as

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[5] FTB appealed that judgment and attorney fee order, and on January 21, 2008, Division Five of this court filed its opinion in the consolidated appeals *Northwest Energetic Services, LLC v. Franchise Tax Bd.* (2008) 159 Cal.App.4th 841, review denied June 11, 2008 (*Northwest*).

applied to these LLC's, former 17942 would not violate the Commerce Clause. FTB argued that the decision following the *Northwest* trial and in this case therefore only applied to 7 percent of registered LLC's that had no income from California sources, or, like Ventas, had income from both inside and outside California. These two categories of LLC's together paid 21.5 percent of the levy paid annually under former section 17942.

The court found both estimates to be somewhat speculative, but concluded that the economic benefit secured by this case was "at least the $215 million" in refunds "due to California LLCs with activities within and without California." The court relied upon this estimate both as a factor in concluding that the litigation had produced considerable pecuniary benefits for a large class of persons, and as a factor in applying an upward adjustment to the lodestar figure, albeit a much more modest increase than Ventas had sought.[6]

In selecting a multiplier of 1.5, the court weighed the additional benefits conferred by the litigation, including "the preservation of valuable resources,

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[6] FTB does not dispute that Ventas demonstrated the cost of private enforcement exceeded the potential benefit to any individual LLC. Ventas submitted an expert declaration below explaining that one of the reasons former section 17942 had not been challenged was that the maximum refund for any LLC would be $11,790 per year, and that the cost of litigating the Commerce Cause issue would far exceed that amount.

both public and private, and particularly those of the judiciary, by obviating the need for duplicative litigation; and the vindication of important constitutional rights under the Commerce and Due Process Clauses of the United States Constitution, particularly the right to engage in interstate commerce without undue burdens." The court also considered the skill of Ventas's lead counsel, the fact that compensation was contingent and that no one else in the last 10 years had been prepared "to take on this litigation." Against these factors, the court weighed the fact that the work involved was not "wholly" novel because except for the issue of reformation and the related issue of the measure of the refund, this litigation was duplicative or "substantially similar" to the issues litigated in the *Northwest* trial.

The court applied the multiplier of 1.5 to the lodestar figure of $143,343.75, to award fees in the amount of $215,016.

3. Postjudgment[7] Legislation.

On October 10, 2007, the Governor signed into law Assembly Bill No. 198, amending former section

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[7] The notice of entry of judgment in this case was filed on December 14, 2006, and FTB filed a timely notice of appeal on December 19, 2006. The notice of entry of the order awarding fees and costs was filed on May 1, 2007, and FTB filed a timely notice of appeal of this postjudgment order. Ventas filed a cross-appeal of the attorney fee order, but states in its brief that it has withdrawn the cross-appeal.

17942 for taxable years beginning on and after January 1, 2007, and adding section 19394 (Stats. 2007, ch. 381, § 3). The amendment changed the language of former section 17942, subdivision (a) from "total income from all sources reportable to this state" to "total income from all sources derived from or attributable to this state." It also added the following language: "'total income from all sources derived from or attributable to this state' shall be determined using the rules for assigning sales under Sections 25135 and 25136 and the regulations thereunder, as modified by regulations under Section 25137, other than those provisions that exclude receipts from the sales factor." (§ 17942, subd. (b)(1)(B).)

Assembly Bill No. 198 also added section 19394, which specifies that if the levy under former section 17942 is "finally adjudged" to be unconstitutional, the remedy shall be for the FTB to recompute it "only to the extent necessary to remedy the discrimination or unfair apportionment," and refund the difference.

Section 4 of Assembly Bill No. 198 further provides as follows:

"SEC. 4. (a) The Legislature is aware of pending litigation challenging the validity of the fee imposed pursuant to Section 17942 of the Revenue and Taxation Code.

"(b) The amendments made by Section 2 of this act to Section 17942 of the Revenue and Taxation Code, if enacted, shall apply to taxable years beginning on and after January 1, 2007.

"(c) Section 19394 of the Revenue and Taxation Code, as added by Section 3 of this act, shall apply to suits for refunds filed on or after the date of enactment of this act and suits for refunds filed before that date that are not final as of that date.

"(d) Refunds of fees payable as a result of the litigation described in subdivision (a) shall be limited to the amount by which the fee paid, and any interest assessed thereon, exceeds the amount that would have been assessed if the fee had been computed in accordance with subparagraph (B) of paragraph (1) of subdivision (b) of Section 17942 of the Revenue and Taxation Code, as added by the amendments to that section made by Section 2 of this act.

"(e) It is the intent of the Legislature that no inference be drawn in connection with the amendments made by this act to Section 17942 of the Revenue and Taxation Code for any taxable year beginning before January 1, 2007." (§ 19394.)

ANALYSIS

I.

Constitutional Validity of Former Section 17942 As Applied to Ventas

Former section 17942 was enacted in 1994 as part of the Beverly-Killea Limited Liability Company

Act (LLC Act),[8] which authorized the formation, operation, and regulation of LLC's within California. The LLC Act requires any LLC that registers with the Secretary of State to pay the annual minimum tax set forth in section 17941, and to pay a levy pursuant to former section 17942. Subdivision (a) of former section 17942 provides that in addition to the minimum tax, "every limited liability company subject to tax under Section 17941 shall pay annually to this state a fee equal to" specified amounts based upon the amount of "the total income from all sources reportable to this state for the taxable year."

FTB first asks us to determine whether application of the levy under former section 17942 to the income of Ventas, wherever earned and without apportionment according to the percentage of business or income attributable to activities within California, violated the Commerce Clause. We shall conclude that it did, and that former section 17942 is unconstitutional as applied to Ventas. We therefore need not, and do not, decide whether former section 17942 is unconstitutional on its face or whether it violates due process.[9]

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[8] The LLC act was codified as new Title 2.5 to the Corporations Code (Corp. Code, § 17000 et seq.) with conforming amendments to the Revenue and Taxation Code and other codes.

[9] A statute should be found facially unconstitutional only if there are no circumstances under which it can be validly applied. (See *United States v. Salerno* (1987) 481 U.S. 739, 745; *Sanchez v. City of Modesto* (2006) 145 Cal.App.4th 660, 678-679.)

(Continued on following page)

"The negative or dormant implication of the Commerce Clause prohibits state taxation [citation], or regulation [citation], that discriminates against or unduly burdens interstate commerce and thereby 'imped[es] free private trade in the national marketplace.'" (*General Motors Corp. v. Tracy* (1997) 519 U.S. 278, 287.) State statutes imposing taxes on income earned outside the state, or imposing a tax on total income without apportionment to activities within the state, have long been held to violate the Commence Clause. (See, e.g., *Gwin, Etc., Inc. v. Henneford* (1939) 305 U.S. 434, 439-440 [state tax "measured by the entire volume of the interstate commerce" in which taxpayer participates and "not apportioned to its activities within the state" violates the Commerce Clause]; *Greyhound Lines v. Mealey* (1948) 334 U.S. 653, 662-664 [tax on gross receipts from transportation violates Commerce Clause to extent receipts were attributable to activities outside the state].)

FTB contends that former section 17942 is not a tax, but a regulatory fee, and that as such the appropriate commerce clause analysis is the three-part balancing test outlined in *Pike v. Bruce Church, Inc.* (1970) 397 U.S. 137, 142 (*Pike*). FTB asserts that the levy imposed under former section 17942 would pass the *Pike* test because (1) the LLC Act effectuates a

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FTB argues that former section 17942 may be constitutionally applied to other LLC's, including those formed and doing business solely within the state of California.

legitimate local public interest in promoting a new business form, preventing the flow of business and jobs from the state, and protecting Californians who deal with LLC's; (2) the effects of the levy on interstate commerce are only incidental and de minimis because it required Ventas to pay during the years in issue only a fraction of one percent of its total income; and (3) the local benefits Ventas derived from registering with the Secretary of State exceed the minimal burden of the levy.

FTB further contends that, even if the levy imposed by former section 17942 is a tax, it still does not violate the Commerce Clause under the four-part test set forth in *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, 279 (*Complete Auto*). Specifically, FTB asserts the dispositive question in this case is whether former section 17942 satisfies the second prong of the *Complete Auto* Test, i.e., is it fairly apportioned. Fair apportionment requires both "internal consistency"[10] and "external consistency."[11] (*Jefferson Lines, supra,* 514 U.S. at p. 185.) FTB

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[10] "Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." (*Oklahoma Tax Com. v. Jefferson Lines, Inc.* (1995) 514 U.S. 175, 185 (*Jefferson Lines*).

[11] "External consistency . . . looks . . . to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." (*Jefferson Lines, supra,* 514 U.S. at p. 185.)

contends that the internal consistency test is inapplicable, and that Ventas should have been required to demonstrate that the levy imposed by former section 17942 actually adversely impacts interstate commerce more than intrastate commerce.

FTB also contends that the levy imposed by former section 17942 is distinguishable from other state taxes found to violate the Commerce Clause because under the LLC Act, an LLC that registers in California may elect to be taxed as a corporation pursuant to a statutory scheme that does provide a method of apportionment. (§ 23038, subd. (b)(1).) Ventas instead elected to be subject to the levy under former section 17942. FTB asserts this election ameliorates the burden imposed on interstate commerce, and constitutes a waiver, or estops Ventas from challenging the constitutional validity of former section 17942.[12]

All of the foregoing arguments were carefully considered, thoroughly analyzed, and rejected by Division Five of this court in *Northwest, supra,* 159 Cal.App.4th 841. In that case Northwest Energetic Services (Northwest), an LLC organized under the laws of the State of Washington, registered as an LLC with the California Secretary of State pursuant to

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[12] We deferred ruling on Ventas's motion to strike the waiver argument, and other arguments from FTB's reply brief, on the grounds that the arguments were new issues raised for the first time in the reply. The motion to strike is hereby denied.

Corporations Code section 17451. It paid the $800 minimum tax imposed under section 17941, but failed to pay an amount imposed under former section 17942, based on an LLC's "total income from all sources reportable to this state for the taxable year." (Former § 17942, subd. (a).) Northwest had no California customers, made no deliveries in California, and had "no operations, property, inventory, employees, agents, independent contractors or place of business in California." (*Id.* at p. 849.) When FTB notified Northwest that it owed $27,458.13 for amounts due for tax years 1997, 1999, 2000, and 2001, Northwest paid the $27,458.13 and cancelled its registration with the Secretary of State. After exhausting its administrative remedies, it filed a suit for refund. The trial court ruled that, as applied to Northwest, former section 17942 violated the Commerce Clause, and ordered a refund of the entire amount Northwest had paid for the years in issue. (*Id.* at p. 850.)

On appeal, FTB raised all the same arguments it does here. Division Five held that former section 17942 is a tax, not a regulatory fee[13] (*Northwest, supra,* 159 Cal.App.4th at pp. 857-861), and that it violates the Commerce Clause under *Complete Auto, supra,* 430 U.S. 273, because it is not fairly

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[13] Division Five further held that even if former section 17942 were a regulatory fee, it would violate the Commerce Clause under the balancing test articulated in *Pike, supra,* 397 U.S. 137. (*Northwest, supra,* 159 Cal.App.4th at pp. 865-866.)

apportioned. (*Northwest,* at pp. 861-864.) The court held former section 17942 failed the internal consistency test for the following reason: "[I]f the Levy were replicated in every state, an LLC engaging in business in multiple states with the same total income as Northwest would pay the maximum levy in every state in which it did business or registered to do business. An LLC operating only in one state would pay the maximum levy only once. Thus, the Levy places a greater burden on interstate commerce than intrastate commerce." (*Id.* at p. 862.)

The court rejected FTB'S argument that the internal consistency test was inapplicable and that Northwest had to demonstrate by some other means that the tax burdens interstate commerce. It explained that the case upon which FTB relied, *American Trucking Assns., Inc. v. Michigan Pub. Serv. Com.* (2005) 545 U.S. 429 (*American Trucking*), was distinguishable. (*Northwest, supra,* 159 Cal.App.4th at p. 862.) "The Michigan fee in *American Trucking* was a flat fee, 'which does *not* seek to tax a share of interstate transactions, which focuses upon *local* activity, and which is assessed evenhandedly.' [Citation.] Here, by contrast, the Levy is not a flat fee imposed on all LLC's for the privilege of doing business locally in California, but a percentage of the LLC's total *worldwide* income, which therefore *does* tax a share of interstate transactions. Moreover, the court in *American Trucking* did not *reject* the internal consistency requirement altogether. Instead, it found no Commerce Clause violation notwithstanding the absence

of internal consistency, because the petitioners would incur intrastate (*local*) fees in multiple states only by engaging in local business in those states. Here, by contrast, an LLC incurs the Levy based on its total *worldwide* income merely by registering with the state, even if it does no business there." (*Northwest*, at p. 863.)

The court further observed that, as is also the case here, FTB advanced no argument addressing external consistency. (*Northwest, supra,* 159 Cal.App.4th at p. 864.) The court concluded that the levy imposed by former section 17942 also failed the external consistency test "[b]ecause the Levy is measured by the LLC's total income wherever earned, and not just what is earned in California, [and thus] the Levy 'reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State.'" (*Ibid.*, quoting *Jefferson Lines, supra,* 514 U.S. at p. 185.)

Finally, the court rejected FTB's voluntary choice arguments based upon the fact that Northwest could have elected to be taxed as a corporation, a statutory scheme that, unlike former section 17942, provided a method for apportionment and thereby avoided taxation under former section 17942. The court declined to characterize Northwest's decision as consent to be taxed on all income without apportionment, or as a voluntary choice, because an election "to be taxed as a corporation rather than as a passthrough LLC would have more dramatic consequences. Among other things, such an election would

require Northwest to make the same election with the Internal Revenue Service, thus changing the manner in which Northwest and its members would be taxed at the federal level, with likely similar changes in all the other states in which Northwest did business. Avoiding the double-taxation aspect of a corporation (by which the entity is taxed on profits and its members on distributions) is one of the hallmark benefits of an LLC. Indeed, in passing the LLC Act, our Legislature recognized this facet of LLC's as one of the major reasons for such interest in LLC's in the first place. The FTB now would have LLC's surrender this advantage not only in California, but in all other states in which the LLC pays taxes and on its federal tax returns as well, simply so California can impose a tax based on income generated *outside* of California. The idea that this could somehow ameliorate the burdens on interstate commerce, or insulate the Levy from scrutiny under the Commerce Clause altogether, is simply untenable. Nor do we think that LLC's – which our Legislature wanted to *attract* to California in passing the LLC Act – should be forced to endure an unconstitutional assessment merely because they proceeded under the auspices of a California statute (former § 17942)." (*Northwest, supra,* 159 Cal.App.4th at p. 868.)

The court concluded that, as applied to Northwest, former section 17942 violated the Commerce Clause and that Northwest, "which conducted no business in California, is entitled to a refund of the amounts it paid under former section 17942." The

FTB agreed in *Northwest* that the refund should be of the entire amount the LLC had paid for the years in issue because "none of its total income derived from California sources." (*Northwest, supra,* 159 Cal.App.4th at p. 868 & fn. 16.)[14] We find the reasoning in *Northwest* persuasive, adopt it as our own, and conclude that, as applied to Ventas, former section 17942 violates the Commerce Clause to the extent that it fails to provide a method of fair apportionment.

II.

Remedy

FTB next raises two issues concerning the appropriate remedy that were not raised in *Northwest, supra,* 159 Cal.App.4th 841, because the LLC in that case did not conduct any business in California, and FTB did not dispute that Northwest was entitled to a refund of the entire amount it paid for the years in issue. In this case, Ventas conducted at least a portion of its business in California. Therefore, Ventas could have been required to pay a portion of the levy without violating the Commerce Clause had former

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[14] The court in *Northwest, supra,* 159 Cal.App.4th 841 also reversed the attorney fee award. It held that the trial court failed to provide adequate explanation or justification for upward adjustment of the lodestar figure of $219,566.95 to $3.5 million, and directed the trial court, if it chose to enhance the lodestar amount again on remand, to provide a more specific explanation of its reasons. (*Id.* at p. 868.)

section 17942 included a method of fair apportionment. The parties stipulated that if the apportionment methodology California uses for corporations (§ 25128 et seq.) were applied, Ventas's California apportionment percentage would have been 8.06 percent, 8.34 percent and 6.94 percent, respectively, for the years in issue.

In light of the foregoing facts, FTB argues that instead of ordering a refund of the entire amount of tax Ventas paid for the years in issue, the court should either: (1) judicially reform former section 17942 to preserve it against constitutional invalidity and apply it as reformed to Ventas; or (2) limit the amount of the refund in this case to the difference between the amount Ventas actually paid and the amount Ventas could have been taxed without violating the Commerce Clause using a method of fair apportionment. FTB asserts that the amount Ventas could have been taxed for the contested years using a method of fair apportionment can easily be determined by using the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act set forth in sections 25120 to 25139 and the applicable regulations. The parties have already stipulated that Ventas's California apportionment percentage would have been 8.06 percent, 8.34 percent and 6.94 percent, respectively, for the years in issue. FTB further contends that this measure of the refund is, in any event, now mandated by the new section 19394 added by Assembly Bill No. 198. Section 19394 specifies that if the levy under former

section 17942 is "finally adjudged" to be unconstitutional, the remedy in any suit for refund that is not final shall be to recompute the tax in accordance with the apportionment methodology added to former section 17942 by Assembly Bill No. 198, and refund the difference.

Ventas contends that the judicial reformation FTB proposes is not an appropriate remedy because it is inconsistent with the legislative intent at the time former section 17942 was enacted. It further contends that when a state tax violates the Commerce Clause because it is not fairly apportioned, the state must refund the *entire* amount paid, even if a portion of the tax could have been collected without violating the Commerce Clause using a method of fair apportionment. Ventas further contends that the statutory changes enacted by Assembly Bill No. 198 are either invalid or inapplicable to this case because: (1) The changes constitute a *new* tax, and as such had to be approved by a two-thirds vote, pursuant to California Constitution, article XIII, section 3. Since it was not, Ventas asserts the changes made by Assembly Bill No. 198 are ineffective and invalid. (2) Application of 19394 to any suit for refund that was not final as of the date of enactment is a retroactive application of the law that violates due process.

We shall conclude that FTB fails to establish the limited conditions that would support exercise of the power of judicial reformation, and shall decline to reform former section 17942 in the manner FTB suggests. We, however, also conclude that a refund of

the entire amount Ventas paid pursuant to former section 17942 is not compelled by the due process clause, or by any principle of state law. A refund of the difference between the amount Ventas paid and the amount it would have paid based upon income derived from or attributable to California sources, using a method of fair apportionment, would fully cure the Commerce Clause violation. This remedy does not place an unreasonable burden on Ventas because the parties have already agreed what Ventas's California apportionment percentage would have been for the years in issue, if this apportionment methodology were used. We shall therefore reverse and remand to the trial court for further proceedings to determine the amount of the refund. In light of this disposition, we need not reach the question whether application of the changes made by Assembly Bill No. 198 after the judgment in this case was entered would violate the due process clause.

1. Reformation.

FTB argues that former section 17942 can and should be judicially reformed to cure the constitutional invalidity by requiring an LLC's income be sourced to California using the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act set forth in sections 25120 to 25139. It urges this court to judicially reform former section 17942 to so provide. The proposed reformation would essentially rewrite former section

17942 in accordance with the changes added by Assembly Bill No. 198.

"'[A] court may reform – i.e., "rewrite" – a statute in order to preserve it against invalidation under the Constitution, when we can say with confidence that (i) it is possible to reform the statute in a manner that closely effectuates policy judgments clearly articulated by the enacting body, and (ii) the enacting body would have preferred the reformed construction to invalidation of the statute.'" (*Ceridian Corp. v. Franchise Tax Bd.* (2000) 85 Cal.App.4th 875, 889 (*Ceridian*).) "By applying these factors, courts may steer clear of 'judicial policymaking' in the guise of statutory reformation, and thereby avoid encroaching on the legislative function in violation of the separation of powers doctrine." (*Kopp v. Fair Pol. Practices Com.* (1995) 11 Cal.4th 607, 661 (*Kopp*).) The power of judicial reformation has typically been exercised in three categories of cases: "(i) cases concerning procedural safeguards required by the First Amendment and/or principles of procedural due process; (ii) cases concerning classifications underinclusive under the equal protection clause; and (iii) cases concerning otherwise vague or overbroad criminal statutes." (*Id.* at p. 629.)

In the context of cases involving tax statutes that violate the Commerce Clause, the courts have consistently declined to exercise the power of judicial reformation to cure the constitutional violation. For example, in *Ceridian,* the court declined FTB's request that it judicially reform a tax provision that

violated the Commerce Clause by, among other things, allowing a deduction for insurance subsidiary dividends only to corporations domiciled in California. FTB suggested the court could reform the challenged statute by rewriting it also to allow non-California corporations to take the deduction. The court explained that the suggested reformation was not appropriate because the plain language of the deduction provision stated that it applies only to corporations "commercially domiciled" in California. (*Ceridian, supra,* 85 Cal.App.4th at p. 889.) Since the provision was clear and unambiguous on its face, it could not be rewritten based upon divination of some contrary legislative intent from other sources. (*Ibid.*) The court further noted that even if it could reform the provisions to expand the availability of the deduction, "[t]he deductions thus more broadly allowed would still be calculated in accordance with a formula that we have determined violates the commerce clause. As [FTB] recognizes, attempting to rewrite subdivision (b) would involve us in precisely the type of judicial policymaking and encroachment on the legislative function in violation of the separation of powers doctrine, against which the *Kopp* court warned. [Citation.] Thus, reformation is not possible in this case." (*Id.* at p. 889.)

Similarly, in *City of Modesto v. National Med., Inc.* (2005) 128 Cal.App.4th 518 (*City of Modesto*), a city filed suit to recover a tax deficiency assessed under a municipal license tax. The trial court held the license tax was not fairly apportioned to reflect

the percentage of the business actually taking place within the taxing jurisdiction as required under the California constitution. (*Id.* at p. 522-523.) The city amended the ordinance to include an apportionment mechanism, and asked the Court of Appeal to judicially reform the original ordinance in a similar manner. The court declined to do so. It explained: "[T]he original ordinance was adopted in 1958. Thus, it is not possible to divine the intent of that enacting body. Further, reforming the 1958 ordinance to comply with constitutional mandates requires adding a substantive change to the law. Such judicial policy-making and encroachment on the legislative function is improper." (*Id.* at p. 528.)

Nonetheless, FTB asserts that judicial reformation of former section 17942 is possible, without encroaching upon the legislative function, because the phrase "reportable to this state" as used in former section 17942 is, at least arguably, susceptible to the interpretation that it describes only "total income from all sources derived from or attributable to this state." Therefore, FTB reasons, the proposed reformation is not necessarily at odds with the plain language of former section 17942, and would be consistent with the legislative policy judgment underlying this legislation. FTB further suggests that if the Legislature knew that an unapportioned LLC tax would be declared unconstitutional, the Legislature would certainly have chosen to include an apportionment mechanism, because collection of *some* revenue would always be preferable to none.

We cannot say with confidence that the proposed reformation would be consistent with the legislative policy judgment underlying former section 17942, because the legislative history reflects that the Legislature actually considered, and rejected, a version including precisely the language the FTB now suggests. This rejected version based the tax imposed on "gross receipts . . . derived from or attributable to sources within this state." (*Ibid.*) As the court in *Northwest* observed, it is not clear why this language was changed, but "[g]iven the oft-stated legislative desire to maintain revenue neutrality, a reasonable inference is that legislators were concerned that the revenue generated from a fee based only on receipts derived from or attributable to sources within this state would not be sufficient. In other words, California would lose money unless the 'fee' was imposed on non-California business." (*Northwest, supra,* 159 Cal.App.4th at p. 858, fn. 9.) FTB does not suggest an alternate explanation for the deletion of this language from the final version of former section 17942 that would allow us to conclude FTB's proposed reformation "closely effectuates policy judgments clearly articulated by the enacting body" (*Kopp, supra,* 11 Cal.4th at p. at p. 661) at the time former section 17942 was enacted.[15] The remedy of

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[15] The amendments and new section added by Assembly Bill No. 198 leave no doubt that the Legislature *now* intends to impose the tax only upon income derived from or attributable to California sources. FTB does not argue that this subsequent legislation sheds any light upon the Legislature's intent when it

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judicial reformation "is improper when the suggested reformation is *inconsistent* with the Legislature's intent, or when that intent *cannot be ascertained.*" (*Kopp,* at p. 643.)

2. Measure of Refund.

FTB alternatively contends that the court erred by requiring it to refund the entire amount Ventas paid pursuant to former section 17942 for the years in issue. It argues that no principle of federal due process or of state law compels it to refund the entire amount Ventas paid for the years in issue. Instead, FTB argues that Ventas is only entitled to a refund of the difference between the amount it paid pursuant to former section 17942 and the portion that could have been collected consistent with the dictates of the Commerce Clause by apportioning the tax to income derived from or attributable to California sources. Ventas, on the other hand, asserts that in *McKesson Corp. v. Florida Alcohol & Tobacco Div.* (1990) 496 U.S. 18 (*McKesson*), the court held that when a state tax violates the Commerce Clause because it is not fairly apportioned the *only* remedy consistent with federal due process is to refund the *entire* amount.

The appropriate remedy for collection of a tax in violation of the Commerce Clause is, in the first instance, a matter left to the state so long as the

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deleted this language from former section 17942, and we therefore express no opinion on that issue.

remedy it affords comports with federal due process. (*McKesson, supra,* 496 U.S. at p. 32, fn. 16.) In *McKesson,* a licensed wholesale distributor of alcoholic beverages filed a tax refund suit challenging Florida's liquor excise tax scheme on the ground that it discriminated against interstate commerce by giving special rate reductions for beverages that were manufactured from products grown in Florida. (*Id.* at pp. 22-24.) The Florida courts granted injunctive and declaratory relief enjoining future enforcement of the preferential rate reductions, thereby leaving all distributors subject to the liquor tax's nonpreferred rates, but denied McKesson's claim for a refund of at least "'the difference between the disfavored product's tax rate and the favored product's tax rate.'" (*Id.* at p. 25.)

The issue before the court in *McKesson, supra,* 496 U.S. 18 was not the measure of the refund, but rather whether due process required the state to provide *any* refund at all, or whether the state could remediate collection of tax in violation of the Commerce Clause retrospectively by other means, such as retroactive assessments upon taxpayers who had received preferential treatment. The court held that when a state requires a taxpayer to pay taxes first and raise objections to the tax in a "postdeprivation refund action," the state "must provide taxpayers with, not only a fair opportunity to challenge the accuracy and legal validity of their tax obligation, but also a 'clear and certain remedy,' [citation] for any erroneous or unlawful tax collection to ensure that

the opportunity to contest the tax is a meaningful one." (*Id.* at p. 39, fn. omitted.) The court held the remedy must include some form of retrospective relief, but does not necessarily require that the state provide a refund.

The court explained that where the tax is not invalid "in its entirety," but, as in the case before it, was unconstitutional only insofar as it operated in a manner that discriminated against interstate commerce, the state "retains flexibility in responding to this determination. Florida may reformulate and enforce the Liquor Tax during the contested tax period in any way that treats petitioner and its competitors in a manner consistent with the dictates of the Commerce Clause. Having done so, the state may retain the tax appropriately levied upon petitioner pursuant to this reformulated scheme because this retention would deprive petitioner of its property pursuant to a tax scheme that is *valid* under the Commerce Clause." (*McKesson, supra,* 496 U.S. at p. 40.) Therefore, the court held that Florida could, consistent with due process, provide a remedy for the Commerce Clause violation of the excise tax in several ways. It could: (1) refund to the taxpayer "the difference between the tax it paid and the tax it would have been assessed were it extended the same rate reductions that its competitors actually received," (2) "assess and collect back taxes from petitioner's competitors who benefited from the rate reductions during the contested tax period, calibrating the retroactive assessment to create in hindsight

a nondiscriminatory scheme," or (3) fashion a remedy consisting of "a partial refund to petitioner and a partial retroactive assessment of tax increases on favored competitors, so long as the resultant tax actually assessed during the contested tax period reflects a scheme that does not discriminate against interstate commerce." (*Id.* at pp. 40-41.)

Ventas argues that *McKesson, supra,* 496 U.S. 18 further held that, in contrast to a tax that is discriminatory, where, as here, the tax violates the Commerce Clause because it is not fairly apportioned, the state has "no choice" (*id.* at p. 39) but to refund the entire amount of taxes paid, even if it is possible to calculate with reasonable certainty the amount the taxpayer would have paid for the years in question if the tax had been fairly apportioned, without placing an undue burden on the taxpayer.[16]

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[16] We note that the distinction between taxes that are invalid because they are not fairly apportioned and those that are discriminatory can also be elusive because "[a] tax that unfairly apportions income from other States *is a form of discrimination* against interstate commerce." (*Armco, Inc. v. Hardesty* (1984) 467 U.S. 638, 644, italics added.) Similarly under California law a tax that is not fairly apportioned to reflect the percentage of business taking place within the taxing jurisdiction is also sometimes characterized as a tax that "unfairly discriminate[s]" against intercity businesses by placing a burden upon them that is not placed on entirely intracity businesses. (See, e.g., *City of Modesto, supra,* 128 Cal.App.4th at p. 525.)

Ventas's argument is based upon a misreading of the discussion in *McKesson, supra,* 496 U.S. 18 contrasting the range of remedies a state may offer when a state tax violates the Commerce Clause by, for example, taxing intrastate commerce at preferential rates, versus the more limited range of relief that could be offered to redress the collection of a state tax that violates the Commerce Clause because it is not fairly apportioned. In the course of determining whether the state was required to provide *any refund at all,* as opposed to some other form of retrospective relief, the court did draw a distinction between taxes that are "beyond the state's power to impose," and a tax such as the one before it that was "unconstitutional only insofar as it operated in a manner that discriminated against interstate commerce." (*McKesson, supra,* 496 U.S. at p. 39.) In the former circumstance, the Court stated the "State would have had no choice but to 'undo' the unlawful deprivation by refunding the tax previously paid under duress." (*Ibid.*) The clearest example the court gave of such a tax was the collection of a tax on Indian lands that are immune from state taxation. (*Id.* at pp. 33, 39.) The state could not reformulate such a tax to cure its invalidity and enforce it as reformulated during the contested period because the object of the tax, i.e., Indian lands, was absolutely immune regardless of how the tax might be formulated. Therefore, in such a case, the state would have no alternative remedy but to refund the tax. The court did also cite *Atchison, T. & S.F.R. Co. v. O'Connor* (1912) 223 U.S. 280 (*O'Connor*), invalidating a franchise tax most of

which "was apportioned to business conducted wholly outside the State" (*McKesson,* at p. 32), as another example where the only remedial option is a refund. When a tax unduly burdens interstate commerce due to lack of apportionment, an alternative remedy, such as retroactive assessments upon other taxpayers in lieu of a refund, would not cure that type of Commerce Clause violation. The court's point, however, was simply that some type of refund would be the only remedy in such a case. It did not discuss what the *measure* of the refund should be, and certainly did not hold, or even imply, that a state would be required to provide a refund of the entire amount collected under such a state tax provision, even if the state could have collected some portion of the tax for the years in issue using a method of fair apportionment without violating the Commerce Clause. To the contrary, earlier in the opinion, when summarizing the holding in *O'Connor,* the court stated that "the railroad company was entitled to a refund *of the portion of the tax imposed on out-of-state activity.*" (*McKesson,* at p. 32, italics added.) Thus, to the extent that the court made any reference at all to the *measure* of the refund, the court implied that the state was required to refund only the portion that could not be imposed without violating the Commerce Clause.[17] In any event, it certainly did not create any

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[17] The tax in *O'Connor, supra,* 223 U.S. 280 was upon the privilege of doing business and consisted of 2 cents on every $1,000 of the corporation's capital stock. Failure to pay the tax resulted in forfeiture of the privilege of doing business. The

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kind of categorical rule concerning the measure of a refund when a state tax violates the Commerce Clause because it is not fairly apportioned.

We conclude that, although *McKesson, supra,* 496 U.S. 18 does hold that when a tax violates the Commerce Clause because it is not fairly apportioned, a refund is the appropriate remedy, it does not support Ventas's assertion that the refund must be of the entire amount paid. *McKesson* held only that when a tax violates the Commerce Clause because it is not fairly apportioned, the state has "no choice" but to provide a refund because the Commerce Clause violation cannot be cured *by other means* such as a retroactive assessments against those who were taxed at preferential rates. It did not, however, specify the *measure* of the refund that must be provided when a tax violates the commerce clause because it is not fairly apportioned.

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court held the "tax is of the kind decided by this court to be unconstitutional, since the decision below in the present case, even if the temporary forfeiture of the right to do business declared by the statute be confined by construction, as it seems to have been below, to business wholly within the State." (*Id.* at p. 285.) At the time of the decision in *O'Connor,* the Commerce Clause was interpreted to preclude any state tax on interstate commerce, even if fairly apportioned, in effect creating a zone of immunity from state taxation. (See *Complete Auto, supra,* 430 U.S. at p. 278 [overruling *Spector Motor Service v. O'Connor* (1951) 340 U.S. 602 and related line of authority that "reflect[ ] an underlying philosophy that interstate commerce should enjoy a sort of 'free trade' immunity from state taxation"].)

We therefore look to several California decisions that have addressed the question of the appropriate measure of a refund in a tax refund suit when the tax collected is found to violate the Commerce Clause, or equivalent provisions under the state constitution.[18]

In *General Motors Corp. v. City and County of San Francisco* (1999) 69 Cal.App.4th 448 (*General Motors*), this court held that General Motors was entitled to a refund of all taxes it had paid under a municipal ordinance that discriminated against General Motors and other out-of-city manufacturers because in-city manufacturers would be subject to only one tax upon gross receipts from the sale of goods whereas out-of-city manufacturers would be subject to "two taxes – a tax upon the portion of gross receipts attributable to selling activity within the City, and any tax upon gross receipts imposed by another municipality where the seller manufactures its goods." (*Id.* at p. 452.) Our determination that General Motors was entitled to a full refund was not, however, based upon categorizing the tax as violating the commerce clause because it was "discriminatory" or "unapportioned." Instead, we analyzed whether the specific remedy proposed by the City in lieu of a full

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[18] "Despite the absence of a specific 'commerce clause' in the California Constitution, the requirements of equal protection and due process proscribe local taxes that operate to unfairly discriminate against intercity businesses by subjecting them to a tax that is not fairly apportioned to reflect the percentage of the business actually taking place within the taxing jurisdiction." (*City of Modesto, supra,* 128 Cal.App.4th at p. 525.)

refund satisfied the due process parameters for postdeprivation relief outlined in *McKesson, supra,* 496 U.S. 18. The city proposed to refund all selling taxes General Motors could prove it had paid on goods upon which another city had also assessed a manufacturing tax. We held that the proposed remedy failed *substantively* to cure the Commerce Clause violation because, among other reasons, it did not "fully eliminate the discrimination suffered by General Motors . . . because it would still be paying a selling tax to San Francisco while local manufacturers pay a manufacturing tax." (*General Motors,* at p. 456.) Moreover, *procedurally* the proposed remedy was less than the "clear and certain" relief *McKesson* requires, because it placed the burden on the taxpayer to demonstrate double taxation had actually occurred. Moreover, to meet this burden, General Motors would have been required to "produce documentation from 17 years ago that it was otherwise never required to maintain." (*General Motors,* at p. 455.) On those facts, we concluded the alternative remedy proposed by the city would not provide "clear and certain" relief, because it imposed an unreasonable burden of proof upon the taxpayer rendering the proffered remedy inadequate. Absent a reasonable, clear, and certain method of determining the amount of tax the City could have collected without violating the state and federal commerce provision and deducting that from the total amount of tax collected, we held the city was required to refund the entire tax payment General Motors had made under the challenged tax provision. (*Id.* at pp. 454-456, 461.)

In *Macy's Dept. Stores, Inc. v. City and County of San Francisco* (2006) 143 Cal.App.4th 1444 (*Macy's*), Division Three of this court addressed the question whether *McKesson, supra,* 496 U.S. 18 or any principle of state law compelled the city to refund *all* of the business taxes Macy's had paid under a municipal tax scheme found to violate state and federal commerce clause provisions. The challenged tax required a business operating in San Francisco to calculate its tax liability based upon its payroll expense, and again based upon gross receipts, and then to pay whichever amount was greater. (*Macy's,* at p. 1447.) It was undisputed on appeal that the tax failed the internal consistency test because it "could hypothetically discriminate against intercity taxpayers, who might be subject to tax under a payroll expense measure in one jurisdiction and under a gross receipts measure in another, unlike a local taxpayer, who would pay tax only to San Francisco under only one measure." (*Macy's,* at p. 1448.) The trial court had concluded that this court's decision in *General Motors, supra,* 69 Cal.App.4th 448 compelled it to order a refund of the entire amount Macy's had paid for the contested years, and the city appealed. (*Macy's,* at p. 1448.)

The Court of Appeal reversed. It held that the remedy the city proposed, consisting of a partial refund in an amount sufficient to remedy the hypothetical discrimination, effectively placed Macy's in the same position as a local taxpayer, and that no principle of due process or state law required that the city instead refund the entire amount Macy's had

paid. (*Macy's, supra,* 143 Cal.App.4th at pp. 1451-1454.) Division Three correctly stated that this court's decision in *General Motors, supra,* 69 Cal.App.4th 448 did not establish a categorical rule that the only remedy is to provide a full refund.[19] (*Macy's,* at p. 1451.) An expert had calculated that Macy's would have paid 1.2 percent more than a hypothetical taxpayer with only local business, and Macy's did not dispute this estimate. (*Id.* at pp. 1448, fn. 5, 1451.) It therefore was possible to use the estimate to calculate the amount of tax Macy's had been required to pay that a hypothetical local taxpayer would not have had to pay, without placing the burden upon Macy's to prove this amount, or to come forward with documentation in support of its refund claim that it would not otherwise have had reason to keep. Division Three distinguished this court's holding in *General Motors* on these grounds. (*Macy's,* at pp. 1451-1452.) Division Three observed, "[T]here is no claim here that the

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[19] When the court in *Macy's, supra,* 143 Cal.App.4th 1444 stated the case before it was "not a case where a full tax refund is required because the tax 'was beyond the State's power to impose, as was the unapportioned tax' " in *O'Connor, supra,* 223 U.S. 280 (*Macy's,* at p. 1452), it merely recognized the same distinction the court in *McKesson, supra,* 496 U.S. 18 drew between the appropriate remedy when a tax is invalid in its entirety because it is beyond the state's power to impose *under any formulation,* and one that is invalid only insofar as it discriminates against interstate commerce. In any event, any reference in *Macy's* to the appropriate measure of a refund when a tax is not fairly apportioned was dicta, and we do not construe it to create a categorical rule that in such a case the taxing authority has no choice but to refund the *entire* amount paid.

City's proposed remedy is deficient because it is uncertain or would not eliminate the discriminatory effect" of the challenged tax, by placing Macy's in the same position as a local taxpayer. (*Id.* at p. 1451.) The court also rejected the argument that a full refund was required on the ground that the challenged tax provision was void, and therefore of no force and effect. (*Id.* at p. 1454.) Nor was a full refund compelled by article XIII, section 32 of the California Constitution, because that section merely "recognizes the taxpayer's right to refund of an illegal tax, as a corollary to the prohibition against enjoining the collection of any tax, but it does not address the proper measure of refund." (*Id.* at p. 1453.)

The court concluded that the measure of the refund the city proposed satisfied all the state and federal requirements of due process. "Macy's is entitled to be placed in a position equivalent to that occupied by local taxpaying businesses so it will have paid a valid measure of taxes. [Citation.] In this way, the City may limit Macy's tax refund to the amount necessary to remedy any discrimination from the City's former tandem tax. [Citation.] Macy's is not entitled to a full refund of all business taxes paid between 1995 and 1999. Such a refund would place Macy's in a more favorable position than a local taxpayer during the same period." (*Macy's, supra,* 143 Cal.App.4th at pp. 1454-1455.)

Finally, in *City of Modesto,* the court indirectly addressed some of these same due process principles, in a procedurally different context, when it declined

to judicially reform a municipal tax ordinance to include a method of fair apportionment. The ordinance had been amended to cure the constitutional invalidity by adding a method of fair apportionment, but the court had found that the amendments applied prospectively only. The court explained that due process concerns were among its reasons for declining to judicially reform the ordinance to include a fair apportionment mechanism like the one added by the amendments: "Although here the disputed tax has not yet been collected, the amended ordinance places the burden on [the taxpayer] to prove which gross receipts should be excluded based on out-of-city activities. Thus, if we were to retroactively validate the tax by applying the apportionment provisions, we would be requiring [the taxpayer] to produce documentation from up to nine years ago that it otherwise was never required to maintain. If [the taxpayer] were unable to document its claimed out-of-city activities, the assessed deficiency would remain the same as it was under the unconstitutional tax. This is not a 'clear and certain remedy' but, rather, places an unreasonable and unfair burden on [the taxpayer]." (*City of Modesto, supra,* 128 Cal.App.4th at pp. 529-530.)

Due process concerns similar to those identified in *General Motors, supra,* 69 Cal.App.4th 448 and *City of Modesto, supra,* 128 Cal.App.4th 518 do not exist with respect to FTB's proposed remedy in this case. Ventas does not contend that the partial refund proposed by FTB would not substantively redress the

Commerce Clause violation. FTB proposes only to retain that portion of the levy under former section 17942 that may be fairly apportioned to Ventas's in-state activity, and to refund the balance that would represent the amount collected in violation of the Commerce Clause. Using FTB's measure of the refund does not create any procedural or practical burden for Ventas that would undermine the clarity or certainty of the remedy in a manner inconsistent with due process. The parties have already stipulated to Ventas's California apportionment percentage for each of the years in issue using California's apportionment methodology for corporations. Therefore, allowing the FTB to recalculate the levy for the years in issue will not require Ventas to bear any burden to prove the appropriate apportionment percentage, or to produce documentation in support of the calculation that it might not have retained. If FTB is allowed to recalculate the levy using the stipulated California apportionment percentages for the years in issue, to retain the portion of the levy thereby fairly apportioned to the state, and to refund the difference, Ventas will be placed in the same position it would have been in if it earned all of its income from California sources, or if the levy had been properly apportioned. We know of no other principle of state law of state or federal due process that would entitle it to a remedy that does more than that.[20]

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[20] Only Ventas's refund claim is before us, and our holding is based upon the particular facts in this case. Accordingly, we

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We conclude that the court erred by ordering that Ventas was entitled to a full refund of the entire amount of tax it paid pursuant to former section 17942 for the years in issue. The court should instead have ordered a refund of the difference between the levy actually paid and the amount that could be collected without violating the Commerce Clause using a proper method of apportionment. Accordingly, we shall reverse the judgment to the extent that it orders FTB to refund the entire amount of taxes Ventas paid for the years in issue, and remand to the trial court for further proceedings to redetermine the amount of the refund, in accordance with the view expressed in this opinion.

III.

Attorney Fees

The foregoing disposition, reversing the judgment to the extent that it ordered a refund of the entire amount Ventas paid pursuant to former section 17942, requires that we also reverse the postjudgment award of attorney fees pursuant to Code of Civil Procedure section 1021.5, because we cannot say with

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express no general opinion regarding the appropriate remedy in other cases. Since we are concerned here only with the Ventas's refund claim, the possibility that the remedy FTB proposes could impose an unreasonable burden on a hypothetical taxpayer whose California apportionment percentage is less readily ascertainable, does not preclude application of the remedy in this case, where it is stipulated.

certainty that the court would exercise its discretion the same way had Ventas not prevailed on its contention that it was entitled to a full refund. For example, the trial court's determination that Ventas had demonstrated that a large ascertainable class of persons would significantly benefit from the litigation was based, at least in part, upon an estimate of the total amount of potential refunds that assumed LLC's that had some income attributable or derived from California sources would nonetheless be entitled to a full refund.[21] Similarly, the partial reversal of the underlying judgment could also affect the court's determination that it was appropriate to apply a 1.5 multiplier to the lodestar figure of $143,343.75. One of the factors the court weighed was that much of the work in this case was duplicative of the work in *Northwest, supra,* 159 Cal.App.4th 841, except for the issue of reformation and whether a full or partial refund was due. The court explicitly weighed the duplicative nature of the work factor against the "considerable benefits" secured by Ventas's litigation in determining that the 1.5 multiplier was reasonable. The trial court's assessment of the relative weight of these factors could also reasonably change in light of this court's determination that Ventas was not entitled to the full refund it had obtained from

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[21] The court relied upon FTB's lower estimate of the amount of potential refunds, but even FTB's estimate assumed LLC's that had some income attributable or derived from California sources would nonetheless be entitled to a refund of all tax paid pursuant to former section 17942.

the trial court. Finally, because a "successful party" within the meaning of Code of Civil Procedure section 1021.5 is not the same as the definition of the "prevailing party" pursuant to Code of Civil Procedure section 1032, the partial reversal could conceivably also affect the court's discretionary determination that Ventas is a successful party for the purpose of a fee award.

We also briefly address FTB's contention that section 19717 is the exclusive means of recovering attorney fees in a tax refund suit, because if FTB were correct, Ventas would be ineligible for fees in *any* amount since it failed to file an appeal to the Board of Equalization. (§ 19717, subd. (b)(1).)[22] We therefore would simply reverse, rather than remand for further proceedings to allow the court to exercise its discretion pursuant to Code of Civil Procedure section 1021.5.

In *Northwest, supra,* 159 Cal.App.4th at pp. 869-875, the court carefully considered and rejected each of the arguments FTB raises here in support of its contention that section 19717 is the exclusive means

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[22] We hereby grant FTB's request that we take judicial notice of an excerpt from a federal Joint Committee on Taxation report describing Internal Revenue Code section 7430 as an exclusive provision for an award of litigation costs. For the same reasons stated by the court in *Northwest, supra,* 159 Cal.App.4th at p. 874, we nonetheless reject FTB's argument that this legislative history supports the conclusion that the California Legislature intended section 19717 to be the exclusive means of recovering attorney fees in a tax refund suit.

of recovering attorney fees in a tax refund suit. The court in *Northwest* ultimately concluded: "Attorney fees are not recoverable under Code of Civil Procedure section 1032, subdivision (b) unless they are recoverable under some contract, statute or law. [Citation.] Most tax refund cases are not pursuant to a contract, statute or law that would afford such relief; few would meet the standards of Code of Civil Procedure section 1021.5 or the common fund doctrine. Section 19717 therefore provides an alternative means of recovering attorney fees in the limited instance in which FTB's position is without substantial justification. [¶] Section 19717 and Code of Civil Procedure sections 1032, 1033.5, and 1021.5 are thus readily harmonized. Code of Civil Procedure section 1032, subdivision (b), in conjunction with Code of Civil Procedure section 1033.5, provides a general right to attorney fees where another statute, contract, or law authorizes such an award. One such statute is section 19717, which requires the movant to prove it was a prevailing party within the meaning of section 19717 and limits the movant's recovery as set forth therein. Another such statute is Code of Civil Procedure section 1021.5, which does not compel the movant to prove the requirements of section 19717, but instead requires the movant to establish that it was a 'successful party' in an action resulting in the 'enforcement of an important right affecting the public interest,' conferring a 'significant benefit . . . on the general public or a large class of persons.' [Citation.] Thus, section 19717 and Code of Civil Procedure section 1021.5 (and the common fund doctrine)

provide different remedies befitting different situations." (*Northwest, supra,* at p. 875.)

For the forgoing reasons, we shall also reverse the order granting attorney fees pursuant to Code of Civil Procedure section 1021.5, and remand to allow the court to again exercise its discretion in light of our partial reversal of the underlying judgment. Nothing we have said should be construed as an expression of an opinion as to how that discretion should be exercised.

CONCLUSION

The judgment is affirmed in part and reversed in part. We affirm the court's determination that, as applied to Ventas, former section 17942 violates the Commerce Clause, and that judicial reformation is not an appropriate remedy. We reverse the judgment only with respect to the amount of the refund due, and remand with directions to redetermine the amount, limiting the refund to the difference between the amount Ventas paid pursuant to former 17942, and the amount Ventas would have been required to pay had the tax been fairly apportioned, as more fully described in this opinion.

The postjudgment order awarding attorney fees is also reversed, and the matter is remanded with directions that the court may redetermine eligibility and the amount of reasonable fees in light of our partial reversal of the judgment.

Each party shall bear its own costs on appeal.

STEIN, J.

We concur:

MARCHIANO, P. J.

SWAGER, J.

Trial Court:	The Superior Court of the City and County of San Francisco
Trial Judge:	Hon. Paul H. Alvarado
Counsel for Plaintiff and Respondent:	Silverstein & Pomerantz Amy L. Silverstein Edwin P. Antolin
Counsel for Defendant and Respondent:	Edmund G. Brown, Jr. Attorney General of the State of California Randall P. Borcherding Supervising Deputy Attorney General Jeffrey Rich Deputy Attorney General Marguerite C. Stricklin Deputy Attorney General

SUPERIOR COURT OF THE
STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

VENTAS FINANCE I LLC, a Delaware Limited Liability Company, Plaintiff, v. CALIFORNIA FRANCHISE TAX BOARD, an Agency of the State of California, Defendant.	No. CGC-05-440001 **JUDGMENT** ~~**[Proposed]**~~ [/s/ GC]

JUDGMENT

(Filed Dec. 11, 2006)

The above action came on regularly for trial on May 8, 2006, in Department 305, before the Honorable Paul H. Alvarado, presiding without a jury. Plaintiff appeared by its attorneys Amy L. Silverstein and Edwin P. Antolin of Silverstein & Pomerantz LLP. Defendant appeared by its attorney, Marguerite Stricklin, Deputy Attorney General, of the office of the Attorney General of the State of California. The Court having reviewed the stipulation of facts presented and documents presented and having considered the argument of counsel,

IT IS ORDERED AND ADJUDGED that Plaintiff Ventas Finance I LLC recover from Defendant, Franchise Tax Board, (1) a refund of tax paid by Plaintiff in the amount of $29,540, plus interest thereon as required by law, and (2) costs in the amount of $_____.

Dated: December 11, 2006

By: /s/ Paul H. Alvarado
Hon. Paul H. Alvarado

SUPERIOR COURT OF CALIFORNIA
County of San Francisco

VENTAS FINANCE I, LLC, Plaintiff(s) vs. CALIFORNIA FRANCHISE TAX BOARD, Defendant(s)	Case Number: CGC-05-440001 **CERTIFICATE OF MAILING** (CCP 1013a(4))

I, Greg Chuck, a deputy clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On December 11, 2006, I served the attached JUDGMENT by placing a copy thereof in a sealed envelope, addressed as follows:

AMY L. SILVERSTEIN, ESQ.
EDWIN P. ANTOLIN, ESQ.
SILVERSTEIN & POMERANTZ LLP
55 Hawthorne St., Suite 440
San Francisco, CA 94105

BILL LOCKYER, Attorney General
MARGUERITE C. STRICKLIN, Deputy Attorney General
1515 Clay Street, Suite 2000
Oakland, CA 94612-0550

and, I then placed the sealed envelopes in the outgoing mail at 400 McAllister Street, San Francisco, CA. 94102 on the date indicated above for collection,

attachment of required prepaid postage, and mailing on that date following standard court practices.

Dated: December 11, 2006

GORDON PARK-LI, Clerk

By: /s/ Greg Chuck
GREG CHUCK, Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO
UNLIMITED JURISDICTION

VENTAS FINANCE I, LLC, a Delaware Limited Liability Company, Plaintiffs, vs. CALIFORNIA FRANCHISE TAX BOARD, an Agency of the State of California, and DOES 1 through 50, Defendants.	Case No.: CGC-05-440001 TENTATIVE DECISION (Filed Nov. 7, 2006)

This action came before the Court for trial on May 8, 2006, in Department 305 before the Honorable Paul H. Alvarado, presiding without a jury. Plaintiff Ventas Finance I, LLC, was represented through counsel Amy Silverstein and Edwin Weisman (Silverstein & Pomerantz LLP). Marguerite Stricklin, Deputy Attorney General, appeared on behalf of defendant California Franchise Tax Board. The parties advised the Court that they did not anticipate calling witnesses, but they would file in one month a Joint Stipulation of Facts and Opening Briefs followed by a Reply Brief. They also advised that the issue presented for the Court's decision was whether Revenue and Taxation Code section 17942 (hereinafter section 17942) was unconstitutional as applied to

the plaintiff Ventas during the years 2001 to 2003. The plaintiff contends the Levy on limited liability companies as codified in section 17942 violates the Commerce Clause of the United States Constitution or the Due Process Clauses of the United States and California Constitutions.

Plaintiff and Defendant filed their Opening Trial Brief on June 9, 2006, and June 12, 2006, respectively. Plaintiff's Reply Brief was filed on July 7, 2006; Defendant's was filed on July 14, 2006. The Court heard oral argument from the parties on August 14, 2006, and the matter was deemed submitted on August 30, 2006.

After consideration of the parties' briefs and the authorities cited therein, as well as the oral arguments, this Court finds as follows:

(1) This Levy, pursuant to section 17492, is a tax. The record in this case confirms that the purpose of the Levy is to raise revenue. Also, the revenue from a fee must be dedicated to its purpose, e.g. the regulatory scheme it is intended to fund. Here, however, the Levy is intended for, and used solely for, general governmental purposes. In light of the revenue raising purpose and the deposit of the proceeds into the general fund for general governmental purpose, this Court concludes that the Levy is a tax.

(2) The Levy is unconstitutional as applied to Plaintiff because it is not fairly apportioned. A fundamental constitutional principle governing state

taxation is that a state tax must be fairly apportioned; that is, it must be adjusted to the level of activity in the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), states in part: the tax or levy must (1) be "applied to an activity with a substantial nexus with the taxing state;" (2) be "fairly apportioned;" (3) "not discriminate against interstate commerce:" and (4) be "fairly related to the service provided by the state." The Levy imposed here is based on the plaintiff's worldwide, gross receipts rather than its in-state activities. Since it is unapportioned, it violates the Commerce and Due Process Clauses.

(3) Section 17942 cannot be reformed. Reformation is a narrow exception to the principle that an unconstitutional statute is unenforceable, and is appropriate only when a court "can say with confidence that (i) it is possible to reform the statute in a manner that closely effectuates policy judgments clearly articulated by the enacting body, and (ii) the enacting body would have preferred the reformed construction to invalidation of the statute." *City of Modesto v. National Med., Inc.,* 128 Cal.App.4th at 528 (2005). Adding an apportionment mechanism as Defendant suggests would run contra to the Legislature's expressed intent. The legislative history establishes that the Legislature considered and rejected apportionment of the Levy. Defendant has provided no evidence of the type of apportionment mechanism the Legislature would have enacted. Neither the

statute nor the legislative history contains any indication of the type of apportionment scheme the Legislature would have enacted.

CONCLUSION

For the foregoing reasons, this Court finds that the Levy imposed on the plaintiff under section 17942 is an unapportioned tax, it violates the Commerce Clause of the United States Constitution and the Due Process Clauses of the California and United States Constitutions, and the statutory language of section 17942 cannot be reformed. Accordingly, section 17942 is invalid and Ventas is entitled to a refund of all amounts paid, plus interest and costs as provided by law.

Pursuant to Rule of Court, rule 232(a), a Statement of Decision, if requested, will be prepared by the plaintiff together with a proposed judgment. If a Statement of Decision is not requested within 10 days, this Tentative Decision shall be the Statement of Decision.

DATED: November 6, 2006. /s/ Paul H. Alvarado
PAUL H. ALVARADO
Judge of the
Superior Court

CERTIFICATE OF SERVICE BY MAIL

(Code Civ. Proc. 1013a(4))

I, BETH WILBER /s/ Beth Wilber, a deputy clerk of the Superior Court for the City and County of San Francisco, certify that:

1) I am not a party to this action;

2) On NOV 07 2006, I served the attached:

TENTATIVE DECISION

by placing a copy thereof in a sealed envelope, addressed as follows:

Amy L. Silverstein, Esq.
Edwin Weisman, Esq.
Silverstein & Pomerantz LLP
55 Hawthorne Street, Suite 440
San Francisco, CA 94105

Marguerite C. Stricklin, Esq.
Office of the Attorney General
1515 Clay Street, 20th Floor
P. O. Box 70550
Oakland, CA 94612

and,

3) I then placed the sealed envelope in the outgoing mail at 400 McAllister Street, San Francisco, CA 94102-4514 on the date indicated above for collection, attachment of required prepaid postage, and mailing on that date following standard court practices.

DATED: NOV 07 2006

GORDON PARK-LI, Clerk

By: /s/ Beth Wilber
BETH WILBER, Deputy

Court of Appeal, First Appellate District, Div. 1 –
Nos. A116277/A117751

S166870

IN THE SUPREME COURT OF CALIFORNIA

En Banc

VENTAS FINANCE I, LLC,
Plaintiff and Respondent,

v.

CALIFORNIA FRANCHISE TAX BOARD,
Defendant and Appellant.

(Filed Nov. 12, 2008)

The petition for review is denied.

Baxter, Chin, and Corrigan, JJ., are of the opinion the petition should be granted.

GEORGE
Chief Justice

Assembly Bill No. 198

CHAPTER 381

An act to amend Section 17942 of, and to add Section 19394 to, the Revenue and Taxation Code, relating to limited liability companies, to take effect immediately, tax levy.

[Approved by Governor October 10, 2007.
Filed with Secretary of State October 10, 2007.]

LEGISLATIVE COUNSEL'S DIGEST

AB 198, Committee on Budget. Income taxes: limited liability companies: apportionment.

The Personal Income Tax Law requires every limited liability company subject to a specified tax to pay annually to this state a fee equal to specified amounts based upon total income from all sources reportable to this state. That law defines total income as gross income, as defined, plus the cost of goods sold, as specified.

This bill, for taxable years beginning on and after January 1, 2007, would clarify that total income from all sources reportable to this state means gross income, as defined, plus the cost of goods sold, as specified, derived from or attributable to this state within the meaning of specified provisions of the Corporation Tax Law relating to apportionment and allocation, as provided. This bill would make legislative findings and declarations regarding the necessity for the equitable treatment of limited liability companies.

Existing law provides, for the purposes of specified taxes, that if any deduction, credit, or exclusion administered under the Personal Income Tax Law or the Corporation Tax Law is finally adjudged discriminatory against a national banking association under a specified federal law, or is for any reason finally adjudged invalid, or discriminatory under the California Constitution or the laws or Constitution of the United States, the tax shall be recomputed by the Franchise Tax Board, as specified.

This bill would provide that if a fee imposed under a specified section is finally adjudged as discriminatory or unfairly apportioned under the California Constitution or the laws or the Constitution of the United States, the fee of a disfavored taxpayer that files, or has filed, a timely claim for refund asserting discrimination or unfair apportionment shall be recomputed by the Franchise Tax Board for the taxable year in question, as of the time of allowance of the recomputation, only to the extent necessary to remedy the discrimination or unfair apportionment not otherwise relieved by existing law, and that the amount of the fee as originally computed shall be subject to the provisions relating to original computations.

This bill would make findings with regard to actions for refunds of fees.

This bill would take effect immediately as a tax levy.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares that the changes made by this act with respect to Section 17942 of the Revenue and Taxation Code are necessary to provide for the equitable tax treatment for limited liability companies in light of the following:

(a) The California Limited Liability Act (Ch. 1200, Stats. 1994) authorized limited liability companies for the first time to organize and register in the state. The Legislature was advised that an increasing number of businesses would organize as limited liability companies rather than corporations, resulting in a decrease in income and franchise tax revenue. To offset the loss in tax revenue, certain limited liability companies are required to pay an annual fee based on total income from all sources reportable to the state.

(b) The Legislature finds and declares that its intent in adopting Section 17942 was to ensure that limited liability companies pay a fair and appropriate amount to the State of California, consistent with constitutional limits, and the changes made by this act with respect to Section 17942 serve a public purpose and are in furtherance of the public interest in the fair taxation of limited liability companies doing business in the state by applying the apportionment and allocation provisions to total income for

purposes of determining the amount of the limited liability company fee.

(c) The Legislature further finds and declares that this act serves a public purpose and sound tax policy by affording equitable tax treatment to many taxpayers doing business in this state with the expectation of paying a limited liability company fee that is relative to the level of activity in the state.

SEC. 2. Section 17942 of the Revenue and Taxation Code is amended to read:

17942. (a) In addition to the tax imposed under Section 17941, every limited liability company subject to tax under Section 17941 shall pay annually to this state a fee equal to:

(1) Nine hundred dollars ($900), if the total income from all sources derived from or attributable to this state for the taxable year is two hundred fifty thousand dollars ($250,000) or more, but less than five hundred thousand dollars ($500,000).

(2) Two thousand five hundred dollars ($2,500), if the total income from all sources derived from or attributable to this state for the taxable year is five hundred thousand dollars ($500,000) or more, but less than one million dollars ($1,000,000).

(3) Six thousand dollars ($6,000), if the total income from all sources derived from or attributable to this state for the taxable year is one million dollars ($1,000,000) or more, but less than five million dollars ($5,000,000).

(4) Eleven thousand seven hundred ninety dollars ($11,790), if the total income from all sources derived from or attributable to this state for the taxable year is five million dollars ($5,000,000) or more.

(b)(1)(A) For purposes of this section, "total income from all sources derived from or attributable to this state" means gross income, as defined in Section 24271, plus the cost of goods sold that are paid or incurred in connection with the trade or business of the taxpayer. However, "total income from all sources derived from or attributable to this state" shall not include allocation or attribution of income or gain or distributions made to a limited liability company in its capacity as a member of, or holder of an economic interest in, another limited liability company if the allocation or attribution of income or gain or distributions are directly or indirectly attributable to income that is subject to the payment of the fee described in this section.

(B) For purposes of this section, "total income from all sources derived from or attributable to this state" shall be determined using the rules for assigning sales under Sections 25135 and 25136 and the regulations thereunder, as modified by regulations under Section 25137, other than those provisions that exclude receipts from the sales factor.

(2) In the event a taxpayer is a commonly controlled limited liability company, the total income from all sources derived from or attributable to this

state, taking into account any election under Section 25110, may be determined by the Franchise Tax Board to be the total income of all the commonly controlled limited liability company members if it determines that multiple limited liability companies were formed for the primary purpose of reducing fees payable under this section. A determination by the Franchise Tax Board under this subdivision may only be made with respect to one limited liability company in a commonly controlled group. However, each commonly controlled limited liability company shall be jointly and severally liable for the fee. For purposes of this section, commonly controlled limited liability companies shall include the taxpayer and any other partnership or limited liability company doing business (as defined in Section 23101) in this state and required to file a return under Section 18633 or 18633.5, in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

(c) The fee assessed under this section shall be due and payable on the date the return of the limited liability company is required to be filed under Section 18633.5, shall be collected and refunded in the same manner as the taxes imposed by this part, and shall be subject to interest and applicable penalties.

SEC. 3. Section 19394 is added to the Revenue and Taxation Code, to read:

19394. If the fee provided under Section 17942 is finally adjudged to be discriminatory or unfairly

apportioned under the California Constitution, or the laws or the Constitution of the United States, the fee of a disfavored taxpayer that files, or has filed, a timely claim for refund within the period allowed by this part asserting discrimination or unfair apportionment shall be recomputed by the Franchise Tax Board for the taxable year in question, as of the time of allowance of the recomputation, only to the extent necessary to remedy the discrimination or unfair apportionment that is not otherwise relieved by Section 19393 and the amount of the fee, as originally computed, shall be subject to the provisions hereof relating to original computations.

SEC. 4. (a) The Legislature is aware of pending litigation challenging the validity of the fee imposed pursuant to Section 17942 of the Revenue and Taxation Code.

(b) The amendments made by Section 2 of this act to Section 17942 of the Revenue and Taxation Code, if enacted, shall apply to taxable years beginning on and after January 1, 2007.

(c) Section 19394 of the Revenue and Taxation Code, as added by Section 3 of this act, shall apply to suits for refunds filed on or after the date of enactment of this act and suits for refunds filed before that date that are not final as of that date.

(d) Refunds of fees payable as a result of the litigation described in subdivision (a) shall be limited to the amount by which the fee paid, and any interest assessed thereon, exceeds the amount that would

have been assessed if the fee had been computed in accordance with subparagraph (B) of paragraph (1) of subdivision (b) of Section 17942 of the Revenue and Taxation Code, as added by the amendments to that section made by Section 2 of this act.

(e) It is the intent of the Legislature that no inference be drawn in connection with the amendments made by this act to Section 17942 of the Revenue and Taxation Code for any taxable year beginning before January 1, 2007.

SEC. 5. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

STATE STATUTES

Cal. Rev. & Tax. Code § 17942 (as in effect during 2001-2003).

(a) In addition to the tax imposed under Section 17941, every limited liability company subject to tax under Section 17941 shall pay annually to this state a fee equal to:

(1) Nine hundred dollars ($ 900), if the total income from all sources reportable to this state for the taxable year is two hundred fifty thousand dollars ($ 250,000) or more, but less than five hundred thousand dollars ($ 500,000).

(2) Two thousand five hundred dollars ($ 2,500), if the total income from all sources reportable to this state for the taxable year is five hundred thousand dollars ($ 500,000) or more, but less than one million dollars ($ 1,000,000).

(3) Six thousand dollars ($ 6,000), if the total income from all sources reportable to this state for the taxable year is one million dollars ($ 1,000,000) or more, but less than five million dollars ($ 5,000,000).

(4) Eleven thousand seven hundred ninety dollars ($ 11,790), if the total income from all sources reportable to this state for the taxable year is five million dollars ($ 5,000,000) or more.

(5) This subdivision shall apply to taxable years beginning on or after January 1, 1997.

(6) The changes made to this subdivision by the act adding this paragraph shall apply to taxable years beginning on or after January 1, 2001.

(b)(1) For purposes of this section, "total income" means gross income, as defined in Section 24271, plus the cost of goods sold that are paid or incurred in connection with the trade or business of the taxpayer. However, "total income" shall not include allocation or attribution of income or gain or distributions made to a limited liability company in its capacity as a member of, or holder of an economic interest in, another limited liability company if the allocation or attribution of income or gain or distributions are directly or indirectly attributable to income that is subject to the payment of the fee described in this section.

(2) In the event a taxpayer is a commonly controlled limited liability company, the total income from all sources reportable to this state, taking into account any election under Section 25110, may be determined by the Franchise Tax Board to be the total income of all the commonly controlled limited liability company members if it determines that multiple limited liability companies were formed

for the primary purpose of reducing fees payable under this section. A determination by the Franchise Tax Board under this subdivision may only be made with respect to one limited liability company in a commonly controlled group. However, each commonly controlled limited liability company shall be jointly and severally liable for the fee. For purposes of this section, commonly controlled limited liability companies shall include the taxpayer and any other partnership or limited liability company doing business (as defined in Section 23101) in this state and required to file a return under Section 18633 or 18633.5, in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

(c) The fee assessed under this section shall be due and payable on the date the return of the limited liability company is required to be filed under Section 18633.5, shall be collected and refunded in the same manner as the taxes imposed by this part, and shall be subject to interest and applicable penalties.

Cal. Rev. & Tax. Code § 25120.

As used in Sections 25120 to 25139, inclusive, which shall hereafter be referred to as "this act," unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular

course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Nonbusiness income" means all income other than business income.

(e) "Sales" means all gross receipts of the taxpayer not allocated under Sections 25123 through 25127 of this code.

(f) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

Cal. Rev. & Tax. Code § 25121.

Any taxpayer having income from business activity which is taxable both within and without this state shall allocate and apportion its net income as provided in this act.

Cal. Rev. & Tax. Code § 25122.

For purposes of allocation and apportionment of income under this act, a taxpayer is taxable in another state if (a) in that state it is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (b) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Cal. Rev. & Tax. Code § 25123.

Rents and royalties from real or tangible personal property, capital gains, interest, dividends, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in Sections 25124 through 25127 of this act.

Cal. Rev. & Tax. Code § 25124.

(a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rent and royalties from tangible personal property are allocable to this state:

(1) If and to the extent that the property is utilized in this state, or

(2) In their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws

of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

Cal. Rev. & Tax. Code § 25125.

(a) Capital gains and losses from sales of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales of tangible personal property are allocable to this state if:

(1) The property had a situs in this state at the time of the sale, or

(2) The taxpayer's commercial domicile is in this state and the taxpayer is not

taxable in the state in which the property had a situs.

(c) Except in the case of the sale of a partnership interest, capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

(d) Gain or loss on the sale of a partnership interest is allocable to this state in the ratio of the original cost of partnership tangible property in the state to the original cost of partnership tangible property everywhere, determined at the time of the sale. In the event that more than 50 percent of the value of partnership's assets consist of intangibles, gain or loss from the sale of the partnership interest is allocated to this state in accordance with the sales factor of the partnership for its first full tax period immediately preceding the tax period of the partnership during which the partnership interest was sold.

Cal. Rev. & Tax. Code § 25126.

Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state.

Cal. Rev. & Tax. Code § 25127.

(a) Patent and copyright royalties are allocable to this state:

(1) If and to the extent that the patent or copyright is utilized by the payor in this state, or

(2) If and to the extent that the patent or copyright is utilized by the payor in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

Cal. Rev. & Tax. Code § 25128.

(a) Notwithstanding Section 38006, all business income shall be apportioned to this state by multiplying the business income by a

fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four, except as provided in subdivision (b) or (c).

(b) If an apportioning trade or business derives more than 50 percent of its "gross business receipts" from conducting one or more qualified business activities, all business income of the apportioning trade or business shall be apportioned to this state by multiplying business income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

(c) For purposes of this section, a "qualified business activity" means the following:

(1) An agricultural business activity.

(2) An extractive business activity.

(3) A savings and loan activity.

(4) A banking or financial business activity.

(d) For purposes of this section:

(1) "Gross business receipts" means gross receipts described in subdivision (e) of Section 25120 (other than gross receipts from sales or other transactions within an apportioning trade or business between members of a group of corporations whose income and apportionment factors are required to be included in a combined report under Section 25101,

limited, if applicable, by Section 25110), whether or not the receipts are excluded from the sales factor by operation of Section 25137.

(2) "Agricultural business activity" means activities relating to any stock, dairy, poultry, fruit, furbearing animal, or truck farm, plantation, ranch, nursery, or range. "Agricultural business activity" also includes activities relating to cultivating the soil or raising or harvesting any agricultural or horticultural commodity, including, but not limited to, the raising, shearing, feeding, caring for, training, or management of animals on a farm as well as the handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated.

(3) "Extractive business activity" means activities relating to the production, refining, or processing of oil, natural gas, or mineral ore.

(4) "Savings and loan activity" means any activities performed by savings and loan associations or savings banks which have been chartered by federal or state law.

(5) "Banking or financial business activity" means activities attributable to dealings

in money or moneyed capital in substantial competition with the business of national banks.

(6) "Apportioning trade or business" means a distinct trade or business whose business income is required to be apportioned under Sections 25101 and 25120, limited, if applicable, by Section 25110, using the same denominator for each of the applicable payroll, property, and sales factors.

(7) Paragraph (4) of subdivision (c) shall apply only if the Franchise Tax Board adopts the Proposed Multistate Tax Commission Formula for the Uniform Apportionment of Net Income from Financial Institutions, or its substantial equivalent, and shall become operative upon the same operative date as the adopted formula.

(8) In any case where the income and apportionment factors of two or more savings associations or corporations are required to be included in a combined report under Section 25101, limited, if applicable, by Section 25110, both of the following shall apply:

(A) The application of the more than 50 percent test of subdivision (b) shall be made with respect to the "gross business receipts" of the entire apportioning trade or business of the group.

(B) The entire business income of the group shall be apportioned in accordance with either subdivision (a) or (b), as applicable.

Cal. Rev. & Tax. Code § 25129.

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the taxable year.

Cal. Rev. & Tax. Code § 25130.

Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

Cal. Rev. & Tax. Code § 25131.

The average value of property shall be determined by averaging the values at the beginning and ending of the taxable year but the Franchise Tax Board may require the averaging of monthly values during the taxable year if reasonably required to reflect properly the average value of the taxpayer's property.

Cal. Rev. & Tax. Code § 25132.

The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the taxable year by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

Cal. Rev. & Tax. Code § 25133.

Compensation is paid in this state if:

(a) The individual's service is performed entirely within the state; or

(b) The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(c) Some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

Cal. Rev. & Tax. Code § 25134.

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the

denominator of which is the total sales of the taxpayer everywhere during the taxable year.

Cal. Rev. & Tax. Code § 25135.

Sales of tangible personal property are in this state if:

(a) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale.

(b) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.

(c) This section shall become operative on December 1, 2000.

Cal. Rev. & Tax. Code § 25136.

Sales, other than sales of tangible personal property, are in this state if:

(a) The income-producing activity is performed in this state; or

(b) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

Cal. Rev. & Tax. Code § 25137.

If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting;

(b) The exclusion of any one or more of the factors;

(c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Cal. Rev. & Tax. Code § 25138.

This act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it. Enactment of Article IV of the Multistate Tax Compact (as set forth in Section 38006 of the code) pertaining to the allocation and apportionment of income shall be construed as a reenactment of Sections 25120 to 25137, inclusive, without any inference that a change in interpretation is implied by such enactment.

Cal. Rev. & Tax. Code § 25139.

Sections 25120 to 25139, inclusive, may be cited as the Uniform Division of Income for Tax Purposes Act.

23
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No. 08-1022

IN THE

Supreme Court of the United States

VENTAS FINANCE I LLC
Petitioner,

v.

CALIFORNIA FRANCHISE TAX BOARD
Respondent.

On Petition for a Writ of Certiorari to the Court of Appeal of California, First Appellate District

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF *AMICUS CURIAE* COUNCIL ON STATE TAXATION IN SUPPORT OF PETITIONERS

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Council on State Taxation ("COST") respectfully requests leave to file a Brief *Amicus Curiae* in support of Petitioners. The interest of COST as *amicus curiae* is described *infra* at Brief, pp. 1. Counsel for Petitioners has consented to COST's filing of an *amicus* brief. Despite COST'S qualifications to submit an *amicus* brief, Counsel for Respondents has refused to consent to the filing of such a brief. There are distinct two reasons why COST should be allowed to file as an *amicus* in this case.

First, with respect to the Petition filed in this case, COST makes additional observations concerning the constitutional implications of the remedy afforded by the Franchise Tax Board after finding the underlying tax unconstitutional. A full exposition of the constitutional controversies stemming from this case by all interested and eligible amicus is ultimately to the benefit of the Court in its administration of writs for certiorari.

Second, COST members have a compelling interest in the Due Process issues presented by this case. COST and its members are uniquely familiar with the potential effect of the California Appellate Court's decision on state tax litigation beyond the borders of California.

Respectfully submitted,

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF AMICUS CURIAE	1
SUMMARY OF THE ARGUMENT	2
ARGUMENT	4
I. THE DUE PROCESS CLAUSE PROHIBITS A TAXING JURISDICTION FROM CHANGING THE NATURE OF A REMEDY DURING LITIGATION THAT RESULTS IN AN IMPERMISSIBLE "BAIT AND SWITCH."	4
A. California "Baited" Ventas With The Remedy Providing for Refund of Unconstitutional Taxes.	6
B. California "Switched" The Remedy in Mid-Course.	8
II. REVIEW OF THE QUESTIONS PRESENTED WILL HAVE RAMIFICATIONS IN MANY STATES	8
CONCLUSION	10

TABLE OF AUTHORITIES

CASES — Page

Ceridian Corp v. Franchise Tax Board, 102 Cal. Rptr. 2d 611 (Cal. Ct. App. 2000) 7

G. Thomas Surtees, as Comm'r of the Ala. Dept. of Rev., No. CV-01-1106, 2008 WL 4369259 (Ala. Sept. 26, 2008) 9

Johnson Controls, Inc., et al., v. Kentucky, No. 3:07-CV-65-KKC, 2008 WL 594467 (E.D. Ky. Feb. 29, 2008) 9

McKesson Corp. v. Div. of Alcoholic Beverages, 496 U.S. 18 (1990) 2, 4, 5

Newsweek, Inc. v. Florida Dept. of Revenue, 522 U.S. 442 (1998) 5, 6

Reich v. Collins, 513 U.S. 106 (1994) 3, 5

South Central Bell Telephone Company v. State, 526 U.S. 160 (1999) 9

Ventas Finance I, LLC v. Franchise Tax Board, 81 Cal. Rptr. 3d 823 (Cal. Ct. App. 2008) 6, 8

STATUTES

Cal. Rev. & Tax. Code § 19382 ..... 6, 7

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BRIEF OF *AMICUS CURIAE* COUNCIL ON STATE TAXATION IN SUPPORT OF PETITIONERS

INTEREST OF AMICUS CURIAE

This brief amicus curiae in support of Petitioner ("Ventas") is filed on behalf of the Council On State Taxation ("COST").[1] COST is a non-profit trade asso-

[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus curiae* has made a monetary contribution to the preparation or submission of this brief. The parties received timely notice of *amicus's* intent to file this brief. Petitioner has consented to the filing of this brief and their letter has been filed with the Clerk of this Court. Respondent has denied consent.

ciation formed in 1969 to promote equitable and non-discriminatory state and local taxation of multi-jurisdictional business entities. COST represents more than 600 of the largest multistate businesses in the United States; companies from every industry doing business in every state, including companies from every industry segment. COST members have an interest in the appropriate remedy for a taxpayer forced to pay an unconstitutional tax.

COST's primary objectives are to strike down unconstitutional taxation and support taxpayer attempts to obtain appropriate remedies for discriminatory taxes. Multi-jurisdictional entities are particularly susceptible to the threat of unconstitutional taxation because they are present in large numbers of taxing jurisdictions and often lack sufficient political clout in each of them to protect themselves from discriminatory taxation through the political process. When a tax is recognized by the courts as unconstitutional, that decision is rendered meaningless unless it is matched with a constitutionally sufficient remedy. A proper remedy is critical to make the taxpayer whole, but it is also critical that appropriate incentives exist to help prevent unconstitutional taxation in the first instance. COST submits this brief in support of the Petition because the important constitutional issues raised by this case affect all COST member companies.

SUMMARY OF THE ARGUMENT

The finding of the California Court of Appeal fails to satisfy the minimum federal due process requirement of a "clear and certain" remedy that this Court recognized in *McKesson Corp. v. Div. of Alcoholic Beverages*, 496 U.S. 18 (1990). Both the Court of Appeal and the trial court found that the LLC tax statute

unconstitutionally taxed all income without apportionment, and both the Court of Appeal and trial court appropriately concluded that the statute could not be "saved" by judicial reformation to add an apportionment scheme because the legislature intentionally did not include an apportionment scheme. The trial court properly recognized that because the statute was void, California was required to refund all taxes paid under the authority of the statute. By contrast, without citing any authority for its decision, the Court of Appeal allowed only a partial refund of the tax paid based on an apportionment formula the Legislature had expressly considered and unequivocally rejected. The court reasoned that it found no other principle of state law or federal or state due process requiring it to provide Ventas the full refund.

The Supreme Court should review this case for two reasons. First, the holding below represents the classic "bait and switch" that this Court specifically prohibited in *Reich v. Collins*, 513 U.S. 106 (1994). California "baited" Ventas to first prepay the tax with the promise of a remedy for an unconstitutional statute based on either judicial reformation of the statute or invalidation of the statute. Then the court "switched" the remedy in mid-course to a new remedy based neither on judicial reformation nor invalidation of the unconstitutional statute. Instead, the lower court created a new remedy, holding that the State need refund only the difference between the tax originally paid and the amount the State could have constitutionally taxed, rewriting the LLC tax statute, presumably to suit what it believed were superior policy objectives.

Second, absent review by this Court, other courts will follow California's lead-limiting remedies for un-

constitutional taxes to only the bare minimum—even if that requires a court to rewrite the tax statute in question. If courts are permitted to ignore settled remedies for constitutional taxes and invent new remedies from whole cloth at the conclusion of litigation, state and local governments will recognize that there are no negative consequences of enacting an unconstitutional tax from the onset. In turn, states and local governments will conclude that the threat of review by this Court is insufficient for them to refrain from adopting unconstitutional tax schemes. To preserve due process rights of taxpayers nationwide, this case must be reviewed.

ARGUMENT

I. THE DUE PROCESS CLAUSE PROHIBITS A TAXING JURISDICTION FROM CHANGING THE NATURE OF A REMEDY DURING LITIGATION THAT RESULTS IN AN IMPERMISSIBLE "BAIT AND SWITCH."

Review by this court is necessary to ensure proper application of the federal constitutional requirements for refunding discriminatory taxes. In *McKesson*, the U.S. Supreme Court held that states have some choice in their form of refund relief they provide so long as it complies with minimum federal due process requirements. Specifically, the *McKesson* Court held that when a tax is found to discriminate against interstate commerce, the Due Process Clause obligates the taxing authority to provide "meaningful backward-looking relief to rectify any unconstitutional deprivation." *McKesson*, 496 U.S. at 31.

If a state requires a taxpayer to remit its liability before obtaining review of the validity of a specific tax, minimum federal constitutional requirements

are met only if the state later provides taxpayers with a "clear and certain remedy" for any tax subsequently determined to be "erroneous or unlawful." *McKesson*, 496 U.S. at 20. This Court has further interpreted McKesson's "clear and certain" remedy requirement as applied to reformulated tax systems in two notable decisions, *Newsweek, Inc. v. Florida Dept. of Revenue*, 522 U.S. 442 (1998) and *Reich*, 513 U.S. at 106. Each of these decisions has been expunged by the California Court of Appeal's stance in the present case.

In *Reich*, the Supreme court relied on the "clear and certain" remedy requirement in *McKesson* in awarding a full refund to taxpayers assessed under an unconstitutional Georgia statute exempting from tax retirement benefits paid by the state, but not retirement benefits paid by the federal government or private employers. The Court prevented Georgia from unfairly reconstructing its tax scheme in "midcourse" resulting in a "bait and switch." *Reich*, 513 U.S. at 110-111. Georgia's "clear and certain" remedy was a refund statute (the bait) but after the taxpayers filed for relief the state claimed that no refund or such remedy existed (the switch). *Id.* at 111.

Shortly after Reich was decided, this Court issued a summary reversal of Florida's refusal to fully refund an unconstitutional tax. *Newsweek*, 522 U.S. at 442. In *Newsweek*, a magazine publisher sought a refund of sales taxes paid under an unconstitutional taxing regime. The Department of Revenue subsequently denied the refund request by arguing that Newsweek's remedy lay in a prepayment tax challenge, of which it failed to take advantage. Though states have the "flexibility to maintain an exclusively predeprivation remedial scheme, so long as that

scheme is 'clear and certain'," due process prevents the state from applying this sole remedy to taxpayers who relied on the apparent availability of a post-payment refund when paying the tax. *Newsweek*, 522 U.S. at 444 (quoting *Reich*, 513 U.S. at 110-11). Therefore, once a State has established a remedial scheme for the refund of unconstitutional taxes, due process mandates that a taxpayer is entitled to the remedy dictated by that scheme.

As noted, under California law, the established remedy for an unconstitutional statute was judicial reformation (*i.e.*, curing the constitutional defect) or invalidation of the statute if it could not be reformed. However, the Court of Appeal ignored this established remedy and, without citing any authority, fashioned a new remedy out of whole cloth. The only explanation the lower court offered was that it knew of "no other principle of state law or state or federal due process that would entitle [petitioner] to a full [refund]." *Ventas Finance I, LLC v. Franchise Tax Board*, 81 Cal. Rptr. 3d 823, 844 (Cal. Ct. App. 2008). Now, the California Supreme Court's lack of review puts the matter squarely with this Court to decide whether to provide the taxpayer with the due process protections afforded by the U.S. Constitution.

A. California "Baited" Ventas With The Remedy Providing for Refund of Unconstitutional Taxes.

Ventas took the "bait" offered by California's settled law governing remedies for unconstitutional taxes, and paid the unapportioned LLC tax before challenging its constitutionality. Specifically, California law provides for a postpayment refund of taxes later deemed void. Cal. Rev. & Tax. Code § 19382: "[A]fter payment and denial by the Franchise Tax

Board of a claim for refund, any taxpayer claiming that the tax computed and assessed is void in whole or in part may bring an action, upon the grounds set forth in that claim for refund, against the Franchise Tax Board for the recovery of the whole or any part of the amount paid." *Id.* In addition, when a statute is held unconstitutional, California law also allows a court to "save" a State tax statute that would be deemed unconstitutional by reforming the statute when it can be done in a manner consistent with legislative policy and intent. *Ceridian Corp v. Franchise Tax Board*, 102 Cal. Rptr. 2d 611, 621 (Cal. Ct. App. 2000). These requirements protect the taxpayer by prescribing the remedy that may be sought when a tax is suspect as unconstitutional, and also ensure that the courts do not engage in inappropriate judicial policymaking.

Indeed, here both the Court of Appeal and the trial court agreed that the LLC tax violated the Commerce Clause because it was not apportioned. Both courts also properly determined that adding an apportionment scheme was not an appropriate mechanism because reformation of the statute would be inconsistent with legislative intent; the legislature specifically considered and rejected the exact apportionment scheme that the Franchise Tax Board had suggested. Given that the LLC tax statute could not be judicially reformed, the trial court properly concluded that California's settled remedy for unconstitutional taxes required invalidation of the statute and the consequent refund of all amounts paid under such statute. However, the Court of Appeal refused to follow this settled law; hence, the "switch" was on.

B. California "Switched" The Remedy in Mid-Course.

After Ventas took the "bait," the Court of Appeal "switched" the available remedy. Rather than following the settled state law remedy that, under the circumstances, would have required invalidation of the unconstitutional LLC tax and therefore a full refund of all amounts paid by Ventas under the statute, the court determined that the State need only provide "a refund of the difference between the levy actually paid and the amount that could be collected without violating the Commerce Clause using a proper method of apportionment." *Ventas*, 81 Cal. Rptr. 3d 823, 844 (Cal. Ct. App. 2008). The lower court justified the new remedy merely on the basis that it could find "no other principle of state law or state or federal due process that would entitle [petitioner] to a full [refund]." *Id.*

In ignoring its own conclusion that the statute could not be judicially reformed to cure the unconstitutionality, and in declining to invalidate the statute entirely, California's lower court performed just the "switch" that this Court's precedents condemn.

II. REVIEW OF THE QUESTIONS PRESENTED WILL HAVE RAMIFICATIONS IN MANY STATES

This Petition should be granted because the remedies for unconstitutional taxes are vitally important to sound tax administration and represent a recurring issue across the country. The question of an appropriate remedy routinely arises in state tax issues and remains a contentious issue. The lower court opinion in this case stripped Petitioner of any meaningful opportunity to challenge the unconstitutional

tax and removed any penalty to the State by having enacted an unconstitutional tax, thereby eliminating any real disincentive to enact an unconstitutional tax in the first instance.

If a state can ignore promised remedies for unconstitutional taxes and impose a new remedy at the 11th hour of a constitutional challenge, taxpayers like Ventas will be dragged through costly and time-consuming litigation, only to find they have no remedy for the constitutional violation they suffered. The ability for taxpayers to obtain a timely and satisfactory remedy for an unconstitutional tax is a nationally recurring problem that can only be exacerbated by the lower court's decision in this case. For example, Alabama taxpayers continue to be stonewalled by the state in their attempts to obtain refunds for a tax that this Court declared unconstitutional in 1999. *See South Central Bell Telephone Company v. State*, 526 U.S. 160 (1999) (holding that the Alabama franchise tax violated the Commerce and Equal Protection Clauses); *Ex parte G. Thomas Surtees, as Comm'r of the Ala. Dept. of Rev.*, No. CV-01-1106, 2008 WL 4369259 (Ala. Sept. 26, 2008) (ruling on issues faced by foreign corporations still seeking refunds of the unconstitutional franchise tax paid prior to 1999). Similarly, Kentucky—through judicial, legislative, and administrative actions—continues to deny all refund claims relating to a tax position the Kentucky Supreme Court struck down in 1994. *See Johnson Controls, Inc., et al., v. Kentucky*, No. 3:07-CV-65-KKC, 2008 WL 594467 (E.D. Ky. Feb. 29, 2008) (describing the 14-year struggle taxpayers have faced to seek a remedy for overpayment of corporate income tax). The remedy situation in Kentucky has become so dire that taxpayers now seek redress in federal court. The Alabama and Kentucky examples

demonstrate that strong, preemptive action is needed from this Court in order to dissuade states from adopting procedures that perpetually deny taxpayers a fair review.

Faced with these realities, taxpayers will simply submit to unconstitutional taxes rather than challenge them. Without the threat of legal challenges and the possibility of issuing refunds, state and local governments will lack any disincentive to enact unconstitutional taxes. To ensure that protections from unconstitutional taxes are meaningful, this Court should not permit the bait and switch performed by California in this case. This Court must review the decision below to make clear the process due taxpayers who challenge unconstitutional taxes.

CONCLUSION

For the reasons stated above, the petition for writ of certiorari should be granted.

Respectfully submitted,

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